ECONOMICS OF POST-WAR INDIA

BY

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HIND KITABS - BOMBAY

First Published, 1945

By the same author:
Modern Banking in India (New Book Co.)
(2nd edition in press)
& Prof. C. N. Vakil
Currency and Prices in India (Longmans)

PRINTED BY B. G. PRABHU-KOCHREKAR AT THE SHREEKRISHNA MUDRANALAYA, 9TH KHETWADI, BOMBAY 4; AND PUBLISHED BY V. KULKARNI. HIND KITABS. 267 HORNBY ROAD. BOMBAY

To

SUMATI & SUNANDA

People of Post-War World

PREFACE

This small publication consists in the main of essays contributed to different journals from time to time during 1944, according as one aspect or another of the post-war economy became urgent or prominent. It is therefore unavoidable that the underlying assumptions of different analyses are not always identical. Sometimes, problems have been considered under the assumption of a post-war decontrolled economy. Even though this country may eventually adopt a planned economy, such an approach is helpful as enabling a grasp of the economic forces which this economy will have to face and grapple with on the advent of peace. Sometimes, problems have been analysed from the angle of a planned economy, as is indeed necessary and inevitable amidst ideas and ideals dominant at present.

The book does not claim to be a complete treatise on planned economy or even economic planning for India. Such an attempt is not only difficult because of the inadequacy of available material but in fact wasteful and injudicious. Even if all the analytical difficulties of planning or planned economy were fully met—and this is a claim which few responsible economists will make for themselves—the actual practice and stages of action can only be tentative, empirical and even eclectic. For, of all the factors involved in a radical effort of this kind, the factor which is most difficult to forecast and control and must therefore be allowed to shape and express itself by degrees is how our national character will react ultimately to each change and each radical departure. Dogmatism on this issue would be simply foolhardy. Indeed, the present writer is prepared to plead guilty to the conservative fear that rashness may sabotage not merely our present, too obviously inefficient economy, which however can always be repaired with some effort, but our national character itself, which, once lost, might take generations to restore.

The analysis does not raise the question of either the domestic political presumptions or the international consequences and reactions of economic plans or planning. These are spheres in which reasoning is subordinate to man's emotions, and Economics

which starts with a fundamental belief in sane life is ill-suited to confront imperialism, communalism, power politics whether of the blatant or hypocritial kind, and other manifestations of mass insanity and gullibility.

I thank the editors of the *Eastern Economist, Bharat* and *Commerce* for their kind permission to reprint the articles included in this book. I also place on record my thanks to Prof. J. J. Anjaria of the Bombay School of Economics and Prof. P. S. Rege of the Sydenham College for their help and valuable advice from time to time.

Sydenham College,
Bombay.
March 2nd, 1945

S. K. MURANJAN

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CHAPTER I

ECONOMIC PLANNING AND THE BOMBAY PLAN

A plan for the economic development of India need not necessarily conform to planned economy in the strict, scientific sense of the phrase. The authors of the Bombay Plan, however, evidently look on their proposals as offering a planned economy and are at pains to discuss the role of State intervention and democratic principles in their planning. It would, therefore, be both just and certainly more constructive and conduce to clearness of understanding to examine their proposals in the light of the basic principles of planning. In the meanwhile, as a preliminary step, attention has to be drawn to two cognate points of some importance.

International Background of Post-war Planning

It seems to be assumed in many quarters that, between the present war economy and the planned economy of peace, there must intervene a period of transition more or less short. It is difficult to make out how such an idea has managed to take hold of so many minds. When the war ends, whether suddenly or gradually, we shall have at our service a fairly all-pervasive system of controls and a vast apparatus to put into effect any changes we might desire for the future. Provided we have a clear picture of the economic objective in view, it should not be difficult to change and adapt existing controls in such a manner as to dovetail the war economy into the planned economy of the future. What many people conceive of as a transitional interval will then prove to be the important preliminary stage of the new order.

In the second place, we must bear in mind very clearly the kind of world economic order in the midst of which we must seek our economic salvation. In the nineteenth century, co-operation among nations was based on a wide-spread faith in the economic interdependence of nations and the benefit of territorial division of labour. This faith found its concrete expression in two main ways. In spite of the existence of tariffs and much talk of protection, the world enjoyed, in a high

measure, freedom of multilateral trade. Secondly, almost all countries adopted, as a logical sequence, an international monetary standard, the gold standard. When we compare these basic facts of international relationships in the nineteenth century with the predominant trends and tendencies of the present century, a great contrast becomes obvious. It is hardly likely that the post-war world will present such a broadly homogeneous type of economy in different countries as it did during the previous century. It will consist very largely of several types of contrasted and divergent economies. The planned economy with its drastic control of foreign trade, domestic investment, and isolated income and wages structure represents one type of economy which prevails in Russia and which, with many modifications, we hope to establish in this country. England, France and other countries with colonial empires will fall into another category. England appears to have in view a dual policy. On the one hand, she is striving to assure for herself the greater part of the foreign trade of the territories subject to her political control, an objective which explains her anxiety to preserve her sterling *bloc* within the framework of any international monetary agreement. On the other hand, in the same monetary discussions, England has always laid greater emphasis on exchange elasticity and monetary autonomy than on rigid co-ordination, a clear proof of her desire for a measure of independence as against non-sterling countries. The third type of economy will be exemplified by the kind of economic life which the tremendous emotional forces released at the end of the war will inflict on the defeated countries. Amidst this welter and confusion of economic counsels, the United States will tower as a new colossus, aspiring to play in the twentieth century the role of England in the nineteenth century but struggling between the inherited prejudices and vested interests of the past and the logical implications of her new world position. The disappearance of the penalty clause for surplus countries in the final draft of the monetary agreement is a deeply significant and disturbing evidence of her mental dilemma. In the light of this prospect of conflicts and divergences, it is hardly to be expected that international co-operation of the twentieth century will aim at enabling spontaneous economic forces to work in an automatic

manner. It is more consistent with the logic of facts that the co-operation of the future will be one of pacts, compacts, and agreements and that behind this facade will operate not merely rational economics, but political power pure and simple. If this analysis is correct, closed economy rather than inter-country mobility of capital and labour will be more compatible with the spirit of the future.

Planned Economy for Defence

The planned economies of which we were aware till now had for their principal objective the waging of war and, as an incidental benefit, the cure of unemployment. Although war can hardly find a place in our conception of the future India, defence in a world like ours cannot be ignored altogether. Defence raises three economic questions: the ownership or control of certain lines of production directly connected with war; the facility of switching other lines of production from peace to war requirements; and finally, the far-reaching policy of location of industry in general from the strategic rather than the economic point of view. The basic consideration for planning for defence is that the capacity for production and rapid transition from peace output to war output is far more important than a mere accumulation of war output itself. The amazing manner in which accumulated weapons and equipment become obsolete during the course of a war has itself demonstrated, again and again, the danger of depending on accumulation for war, unless the accumulation is confined to mere raw materials. Whatever the detailed arrangements, adaptations in anticipation of war can never mean anything but diminution of welfare and are to be justified only by the dictum of Adam Smith that defence is more important than opulence.

The authors of the Bombay Plan, on the whole, ignore this factor, the postulate of peace being the basis of their whole structure. Only in connexion with the subject of State ownership do they find cause to advert to 'the manufacture of materials exclusively required for war purposes'. In actual practice, this consideration is bound to play a decisive role in many of our projects of the future.

A Minimum Standard through Income Redistribution

The most commonly accepted objective for a planned economy in this country is the assurance of a minimum standard of life for all. It is generally agreed that this objective is not likely to be reached by redistribution of wealth, since, even if no adverse reactions on productions need be apprehended, the surplus available for redistribution is grossly inadequate for the purpose. Nevertheless, under modern conditions, some redistribution of wealth tending towards this result is inevitable even in India. As a matter of fact, the detailed proposals of the Bombay Plan bearing on distribution are neither simple nor insignificant in the aggregate. They may be examined under four different heads:

In the first place, the authors propose to intercept a large part of the bigger incomes by means of direct taxation and transfer the proceeds to the less fortunate sections of society in the form of education, medical relief, sickness insurance, holidays with pay, and subsidized services of public utility concerns. Except where such expenditure can be assumed to be financed ultimately out of increased productivity, the burden must fall partly on trade profits when employers contribute and on the public exchequer. Bearing in mind the war level of taxation or the estimated expenditure under these different heads, it is clear that this transfer of wealth will aggregate to no mean fraction of our national income. The real economic problem of such redistribution is to make sure that it stops short of adverse reactions on production itself—the source from which all redistribution must emanate.

Secondly, there is some idea of influencing or regulating the economic process of distribution or pricing of the factors of production in such a manner as to favour smaller incomes. The Plan argues in favour of minimum wages for agricultural labour and, in a few select industries, for industrial labour as well. But the clearness of their conception is much clouded when it is suggested, in one place, that the minimum should 'continue to be determined on the basis of demand and efficiency', and, in another place, that it 'should be related to the normal wage level prevailing in each industry'. If minimum wage is not to exceed the net productivity of labour, which is a perfectly sound proposition, legislation of this kind

cannot have much usefulness beyond prevention of sweated labour in industries which admit of such conditions. Agricultural labour in its scattered, discontinuous, casual and isolated employment is apt to approximate to sweated conditions. But these very conditions create problems of inspection and administration which make enforcement of law an almost insuperable task.

In the proposals for stabilization of agricultural prices, adjustment of land revenue to prices, elimination of pernicious marketing practices, etc., an effort is obviously made to prevent transfer of wealth prejudicial to peasants' incomes. It is not clear, however, whether the main object in view is merely to neutralize the arbitrary effect and operation of the monetary factor, or it is intended to cover fundamental economic changes as well. The fact is that the scheme gives nothing more than a superficial analysis of this vast and complicated problem. We are discussing this problem separately in another chapter.

Thirdly, it is suggested that an effort should be made to alter the ownership of property, that is, non-human factors of production, in such a manner as to favour the small owners or the traditionally disinherited. Different means are suggested for this purpose. Zamindars are to be bought out. But, in view of the fact that the cultivator in this country is generally either the owner or the occupancy tenant of a holding and holds, on the average, no more than a few acres of land, it is difficult to see how the smaller agricultural incomes are likely to be much enhanced by this measure. The elimination of the zamindar is, of course, helpful, particularly in the distant future, as intensifying economic incentive and productive efficiency. But its effect must not be overrated. Again, heavy death duties are pointed to as diminishing the inequalities of ownership. The fact is that, while they increase the revenues of Government, their property-equalizing effect is to place real resources in the hands of the active rich instead of the old and inheritance-idle rich. As for the effect of death duties on aggregate national income it will depend on whether the savings of the active rich now transferred to the Government are used by it for purposes of investment or increase of consumption. It is to be feared in general that Government

expenditure has a tendency prejudicial to the growth of the capital assets of a community. Another factor under contemplation with the same object in view is a wider distribution of the shares and stocks of joint-stock companies. But, unless this is expected as the outcome of the better distribution of national income achieved by other means and the ensuing wider diffusion of savings, or by a complete reorganization of the investment machinery calculated to attract savings at present repelled from such investment, the omission to suggest any means towards this end reduces the idea to a mere pious hope. Of a similar nature is the hope entertained of regional distribution of industries unless it is to be believed that the loss caused by non-economic location will be more than counterbalanced by the gain of offsetting the immobility of factors of production, particularly labour, by such location. Finally, State industries, if they cover a large part of national life, must diminish the opportunities for private profit and fortunes, but, as we shall see presently, the Plan does not seek to attempt much more than what is the established practice of many advanced countries.

Under the last head must be grouped certain miscellaneous suggestions like improvements in farming, cottage industries, full employment, relief and public works, etc. All these are, however, intended not to alter income-distribution but to raise production and as such must lead us to the main problem, namely, the type of planned economy capable of enlarging our national output.

War Economy with Peace Objective

The apparently unprecedented output of many belligerent economies suggests to some the question whether the principles of a war economy could not be evoked for the purposes of peace as well. A war economy achieves its object in two ways: the curtailment of ordinary consumption and investment, and the concentration of resources thus released on the production of war output, which, it is important to note, consists of a few, narrowly standardized products and has to be achieved in the shortest time almost regardless of costs.

Since a minimum standard of life is the object of a peace economy, it is clear that a peace economy can aim at seizing only the surplus over the minimum incomes of individuals. It

is very unlikely that this surplus will amount to anything in the neighbourhood of the 60 or 70 per cent of the national income which belligerent nations are reported as devoting to purposes of war. Secondly, a war economy secures its supplies very largely through normal channels—Government contractors, factory owners, etc.—guided, supervised, or directed by a host of normal and *ad hoc* Government officers. If the normal machinery of production were capable of the high degree of efficiency implied in a several-fold multiplication of the national output and all that is required be a diversion of the factors of production from unnecessary into necessary production, the problem of poverty should, indeed, be very simple to deal with. But the question of planned economy arises just because the ordinary competetive economy has or is believed to have failed to reach the necessary degree of efficiency. If resources are to be released from unnecessary production, it has to be made sure that these resources are applied in such a manner that the productive efficiency of the whole system is raised in a striking manner.

There is another and a more subtle difficulty which is encountered in the application of the principles of a war economy to peace objectives. Under a war economy, not only does the Government seize the surplus incomes of its subjects and decide the sorts of output to which the surplus shall be devoted, but it actually directs the use of the output itself. If, under peace conditions the Government determines what the output shall be and also places the output directly at the disposal of individuals, no difficulties will arise. If, for example, the surplus is used to advance education etc., the Government shall have provided for both production and consumption simultaneously. But, if the output evoked by the Government is in addition to the output undertakan by private initiative and enterprise, then a problem in distribution and consumption presents itself. On what principles should the Government allocate the output to individual consumers? The best escape from the difficulty would be not to acquire the output itself but to use the surplus to subsidize production, so that output is placed within the reach of the lowest incomes. The greatest danger of such an economy is that the surplus incomes themselves may evaporate, since neither now nor in the near future can surplus incomes

be enjoyed by their owners and to that extent, the whole economic system will work on a much lower plane of wealth and welfare. The fact is that people work hard and earn large incomes under a war economy partly because of hopes of future reimbursements and partly because of the faith that they are defending the country of which they are a living part. Will they work as hard for the economic betterment and welfare of others in the peace-time conviction that those others are a part and parcel of themselves?

In practice, this logical dilemma will be mitigated by two circumstances. Although the Government seizes a large part of the bigger incomes, the residue left in private hands will be sufficient to maintain and sustain private effort and initiative. In the second place, a good part of the Government expenditure will be investment so planned as to enhance the efficiency of, or subsidize, private effort and not to displace or supplement it. A diffusion of higher incomes brought about in this manner may then be expected to create the necessary economic power of consumption in all classes of society.

Such, indeed, appears to be the meaning of the various heads which have been enumerated above as raising the volume of output. The important point to be raised is whether the improvements in farming, cottage industries, full employment, relief and public works, are intended to be undertaken on a scale large enough to justify comparison with the operations of a planned economy. Still more important is it to satisfy ourselves that public investment of this kind will add more to the national income than private investment which it displaces or supplants.

War Economy in Negative Form

It is, indeed, possible to adopt the principle of war economy in a different form, and avoid the responsibility of seizing surplus incomes or purchasing power and directing it into particular channels. War economy strives to curtail necessary as well as superfluous consumption and diverts the resources so released into war output. Since the object of a peace economy is a certain standard of necessary consumption for all, no question of curtailing such consumption arises. The logical task before such an economy is to suppress superfluous consumption and, by

such suppression, induce the released sources to flow into approved and permitted channels. True, except perhaps in the case of a few commodities like precious metals, it is not an easy task to define superfluous or harmful consumption, particularly since such superfluity or wastefulness consists very largely in the quantities, qualities, or varieties, rather than in the substance of the consumption itself. Assuming, however, that such consumption is defined more or less precisely, it is possible to restrict the output of such goods by the control of new capital issues, licensing of new factories, supervision and rationing of the output of existing units of production, etc. In this manner, a large fraction of the incomes of the community can be induced into investment and production of the desired kind.

This particular aspect of planning has not received much definite or sufficient attention in the Plan before us. But some controls mentioned illustratively tend in this direction. The regulation of new capital issues, a system of licence for establishing or extending units, allocation of raw materials, etc. presume the operation of some principle of social priorities of this kind. The rationing and price control of consumers' goods, presumably scarce because of a presumably closed economy, appear to refer to necessaries of life. It would be much more to the point to think of them in connexion with the superfluities of life. Control over foreign trade and exchange is a more intricate matter. It has, of course, a bearing on the particular policy in view—the protection in the ordinary sense of Indian industries referred to by the authors. But its more vital function will arise when, because of planned investment, etc. Indian costs and incomes cease to have any economic relationship with foreign costs and incomes and tend to attract unwanted imports or prejudice desirable exports.

Investment for Future *Per Se*

It is probable that the mere saving of resources caused by the octopus system of rationing and price control has impressed some as a possible source of great opulence. It is vital that the logical bearing of such ideas should be clearly exposed. An individual sometimes saves either to assure plenty for his old age or for his children. Similarly, a country can forgo

present comfort in order to secure a better future for its posterity. The choice between present and future opulence may be wise or unwise in itself. The choice, however, is largely ethical or psychological and an economist *qua* economist can have little to say about it. This particular economic trend is more implied than expressed or recognized in most schemes propounded till now. The road, railway and transport projects which loom so large in the plans of various Indian Governments, the basic industries, public and relief works, as well as rationing and distribution of consumers' goods which are adverted to in the Bombay Plan —all bear this hall-mark on their face. Such investment which, taken with private investment, must tend to outrun the voluntary savings of the public. No doubt it creates incomes in the hands of the consumers but, during the more or less prolonged interval that the investment matures, the swollen incomes impinge on the supplies of consumers' goods which diminish just because labour, raw materials, and other factors are being increasingly diverted into investment. Some of the earliar colossal schemes of the much admired Soviet economy are lurid examples of quite unnecessary privations inflicted by this mere fetish of investment.

Paternal State as Planned Economy

In the two adaptations of planned economy considered above, private initiative and enterprise are preserved largely unimpaired. Under either form, however, the Government is bound to undertake some production and investment in its own hands. But, unless this fraction bears a very large proportion to the total resources free and availble for investment, the new economy will not be much of a fundamental departure from the old competitive economy. Even under a competitive economy, it has always been recognized as proper for a Government to undertake those lines of production in which technical conditions made monopoly inevitable or desirable, or in the case of which, being essential general prerequisites of progress, like scientific and technical education, etc. the benefit cannot be particularized to any individual industry or enterprise.

The Plan before us analyses the question under the three heads, ownership, management, and control of economic enterprises, but, on the whole, favours control as more important

than ownership or management. Public utilities, basic industries, monopolies, industries using or producing scarce natural resources, and industries receiving State aid are specified as enterprises for possible State ownership, whether full or partial. The decision must, in all cases, rest on empirical grounds and may, in actual practice, lead us very near a socialistic economy or very further away from a planned economy. The controls on private enterprise enumerated in the Plan like fixation of prices, limitation of dividends, prescriptions of conditions of work and wages for labour, nomination of Government directors in boards of management, efficiency, auditing, etc., make no important advance on the ameliorations of the capitalistic economy generally suggested or advocated by the supporters of the *status quo.* Taking all the proposals in the aggregate, it is difficult to make out how the picture presented by the Bombay Plan is very different from pre-war England, or any comparable modern society. In its suggestion for an economic civil service, the Plan just touches on the one great bottleneck of all plans, planners, and planning in this country—the adequate supply of competent and morally unimpeachable personnel. To the detached observer what impresses most under a system of controls and restrictions is not its effectiveness but its enormous loopholes and leakages. A system like this has a tendency to bring not the best and most solid elements in the national life of the country but its worst elements—its time-servers, opportunists and mountebanks. It is a matter for grave heart-searchings whether in attempting a system of this kind we may not be imperilling what national character we have built up so slowly and so painfully. In management by semi-public corporations, the authors have done well in drawing attention to a possible next stage in the growth of the 'financial democracy' of joint-stock enterprise which lacks today any genuine element of responsibility to the investing or consuming public.

This discussion makes it clear that the objectives of planning are not less varied than the means suggested for achieving it. This throws a special and grave responsibility on those who advise or criticize. It is necessary to distinguish between different projects and measures according to their tendencies to bear on one objective or another. It is more necessary to make

sure that the measures adopted do not prove self-frustrating, or mutually destructive, or, by disproportionate concentration of effort and resources in particular directions, prejudicial to aggregate maximum welfare.

CHAPTER II

THE FINANCE OF THE BOMBAY PLAN

Any planned investment such as contemplated in the Bombay Plan must start with an estimate of the total resources available for allocation to the different purposes in view. The authors of the Plan have presented their estimate in this manner—

	(Rs. in Crores)	
External Finance		
Hoarded wealth	300	
Sterling Securities	1,000	
Balance of Trade	600	
Foreign Borrowings	700	2,600
Internal Finance		
Savings	4,000	
'Created Money'	3,400	7,400
Total		10,000

Leaving aside inappropriate use of phrases like External and Internal Finance and the inclusion of a dangerous idea like Created Money without any analysis of its intricate and far-reaching implications, the following remarks may be offered as a mere definition of the real issues involved. No effort is made at elaboration, since theoretical analysis would hardly suit the purpose we have in view.

The resources for capital investment must be found in (*a*) domestic savings, whether voluntary or involuntary; (*b*) foreign assets; and (*c*) foreign loans.

To take the domestic savings first, these may be derived from the following sources:

(i) *Normal Voluntary Savings*—The estimate of Rs. 4,000 crores appears to be a slight underestimate, whether considered as a fraction of the ordinary national income or compared with the visible annual growth reflected in bank deposits, post office savings and cash certificates, paid up capital and reserves of joint-stock companies, deposits of co-operative credit societies and net imports of precious metals.

(ii) *Taxation*—Taxation has a tendency to affect adversely not only consumption but also savings. Its deflationary effects may, however, be counterbalanced when the proceeds are used either for investment or for maintaining subnormal incomes at levels presumed in the output for minimum national existence.

(iii) *Hoarded Wealth*—Gold and silver may be evoked by the lead and inspiration of a National Government. They are more likely to be evoked by expectations of changes in their prices. The present prices of a closed market, which are much above the parity of foreign prices, exchange rates, transport costs, etc., may receive some support from depreciation of the sterling and the rupee.

(iv) *Restriction and curtailment of domestic consumption and unncessary imports*—This implies continuation of the rationing and price control of selected articles. Interests of certain classes, no less than the requirements of the Plan, may justify control of imports of precious metals by heavy import duties or otherwise.

(v) *Created Money or Inflation*—(*a*) Since people of relatively fixed incomes like rent receivers, salaried and administrative classes, industrial and agricultural labourers, money-lenders, etc, form only a small minority of income receivers, the scope for creating real resources for investment by forced savings is very limited. While middle class savings and investment, which form a large proportion of our normal savings and investment, may evaporate, the largar incomes of agricultural producers may take the form of mere absorption of currency and those of business men mere extravagant consumption. The price of created money is ultimately inefficient producers and inefficient methods of production. (*b*) Deliberate invocation of created money may prove unnecessary in view of two potential sources of inflation which already exist. Firstly, there is the vast quantity of bank deposits held idle for lack of investment opportunity and vaster hoards of con-

cealed currency brought into existence by the evasion of price control laws and excess profit taxes. Secondly, gradual inflation must ensue as a policy of low interest rates will be insisted on as an essential monetary prerequisite of the contemplated expanding ecnomy. (*c*) If the classes fleeced by 'created money' re-establish at any stage their relative income levels, the initial deflection of demand and its subsequent realignment will compel a discarding of much capital equipment. (*d*) The Plan has for its main object a several-fold increase in the productivity of each individual already in employment. The absorption into employment of individuals who are fully or partially unemployed is only a small part of the Plan. The main problem, therefore, is one of diverting real resources from consumption into investment and not of putting into motion idle resources by a monetary stimulus.

As regards the second source of finance, namely, foreign trade and savings, it may be mentioned at the very outset that

(i) the pre-war excess of exports is not a source of savings, as the excess has been covered by various kinds of invisible imports;

(ii) the termination of payments on account of our former sterling obligations means (*a*) a fall in our exports, larger consumable income at home and, therefore, a larger saving capacity, and (*b*) to the extent that we prefer foreign commodities to spend our increased income on, an increased capacity to pay for them;

(iii) restriction and curtailment of imports will increase our savings and if these are used for importing capital goods, the excess of exports thus created will automatically pay for them.

As regards the question of sterling assets as accumulated savings, (i) to the extent that the sterling assets correspond to the increase of note issue, they constitute its external support in case of adverse trade balance and thus are not free for investment; (ii) to the extent that the accumulation of sterling corresponds to loans raised in India to finance war exports, the sterling assets represent a loan of savings from the public and are available for investment; and (iii) to the extent that the higher incomes and costs caused by the inflation of notes and currency justify a lowering of the exchange rate, a part of the sterling assets may also be released for the contemplated investment.

The question of foreign loans is largely one of implied political conditions and consequences.

The problem of the means available to make payments to foreign countries for the normal and special imports contemplated under the Plan is quite distinct from the problem of finding savings for the proposed volume of investment, as will be seen from the following:

(i) One quarter of the total investment of Rs. 10,000 crores may be set down as the maximum special imports necessary for the fulfilment of the Plan. Assuming that our ordinary exports are not prejudiced by the Plan, a part of these special imports will merely replace our curtailed imports.

(ii) Foreign loans, exports of precious metals, if any, and that part of our sterling assets which is free for investment constitute the additional resources from which payment can be made abroad without requiring internal monetary adjustments.

(iii) The use of that part of our sterling assets which constitutes the backing for our note issue might mean the withdrawal of currency and notes to that extent but this is incompatible with the expansionist character of the Plan.

(iv) The present level of prices and costs in India and eleswhere and the expansionist character of the proposed great investment can be made compatible with the continuation of our normal exports only on the presumption that a controlled lowering of the exchange rate is allowed to take place.

Since the objective is an output of certain commodities and certain proportions of commodities, a control of capital issues and capital market has to be established. Bank loans and advances and banking credit generally will have to be brought into line by similar control.

The adequacy of the Plan is to be judged not by comparison with the level of wealth of other countries or by our own past record, but by the volume of means available for its fulfilment. The efficacy of the mechanism is to be judged not by the means which a possible Russian Revolution may put into our hands, but by the war-time apparatus which we have already evolved. Judged by these criteria, the Plan appears sufficiently ambitious and practicable.

CHAPTER III

THE BOMBAY PLAN—SOME FEATURES

In the last chapter, we examined the financial postulates and implications of the Rs. 10,000-Crore Plan. It is not unnatural that these implications and postulates have held till now the centre of attention. In a community based largely on private property and free enterprise, real economic resources can be diverted into particular channels only by obtaining control over, and directing the flow of, funds. It would be a grave misconstruction of the Plan, however, to mistake what is nothing more than the mechanism and monetary measure of the Plan for its real substance. This real substance is to be sought in the character and composition of the output set before us as our ultimate objective, the order and stages according to which the production plan is to be executed, and finally, the social and moral costs, no less than the economic costs which have to be incurred.

It is clear that a social output in certain pre-ordained proportions implies a corresponding distribution of income or consumption power. This difficulty, along with others like inflation, etc. will diminish in intensity as the expected output materializes. But, as the Plan proceeds from one stage to another, the maladjustments will in no case be other than very serious. The Plan does not contemplate any wholesale regimentation or curtailment of the consumers' choice or sovereignty. Lack of coincidence between actual output and consumers' preferences is, therefore, hardly avoidable. This means two things in practice: the surpluses for which there is no immediate market must go either into reserves or foreign markets, so as to avoid serious break-downs in production. In the case of foreign markets, special subsidies to exports and the reactions of foreign countries to such measures have to be taken into account. The second and more important point is that a production plan, however valuable, as a target or starting point, must not be put into execution except by instalments and subject to constant revision in the light of emerging facts. Any attempt to put through too large a sector of the Plan in too short a time might land the country in wastes of colossal magnitude.

Agriculture in the Plan

As the Plan stands, the proposals for raising our agricultural output appear to be nothing more than a ritual recitation of hopes and aspirations. While the authors recognize the chief causes of agricultural retardation like uneconomic holdings, indebtedness, etc., the only remedy they suggest is co-operative farming and co-operative credit. How the co-operative principle is expected to make greater headway in the future than it has made in the past, the authors do not indicate. This has raised the unfortunate, but probably unwarranted, suspicion that the really operative parts of the Plan are those which bear on the industrial and manufacturing interests of the country, while the agricultural parts constitute a mere verbal ceremonial.

It is indeed. a perplexing feature of the whole Plan that while investment on a large scale is proposed for agriculture, no clue is given as to the type of agricultural organization envisaged. It is likely that the authors have nothing more in view than development of dairy farming, market gardening, and the inevitable reactions of large-scale industrialization on the agricultural economy. While it would be unjustifiable to underrate the operation of these forces, it is surely a strain on credulity to suggest that these changes and improvements could absorb more than a small proportion of the investment, or affect more than a small fraction of the cultivated area. For the main problem of Indian agriculture, namely, a larger output from every acre of cultivated land, a scale of investment has no meaning unless coupled with the type of agricultural organization appropriate to it.

It is rather singular that nothing is said about the vital question of the relationship of agricultural efficiency to land-ownership and land-tenures. An absentee or idle landlord class which exists only to claim directly or indirectly a share in the fruits of labour is surely not an incentive to the peasant cultivator to undertake important improvements or investment. The silence of the Plan on this point was perhaps due to the desire to avoid premature controversies over issues which impinge on vested rights and property. But, at some stage of the Plan, a choice will have to be made between peasant proprietorship, limited only by the requirements of public interests,

and the present chaos over a large part of the country of vested interests of all degrees of parasitism and inefficiency. As things are, there can be only one choice, and that is, universal peasant proprietorship. Whether this is to be achieved by expropriation or compensation, or by a judicious combination of the two methods, must depend on the particular conditions and history of each area. The peasant proprietors themselves will have to submit in all areas to the discipline of national interests. On no point could this discipline be more urgently or more profitably applied than the elimination of fragmentation and uneconomic division of holdings.

By far the most outweighing cause of inefficient agriculture is undoubtedly the uneconomic size of the unit of production over the greater part of the country. As in most other countries, historical and non-economic forces and policies have had more to do with this fixing of the model size of the holding than the pursuit of mere economic self-interest or welfare. Even though the latter stand-point were adopted as the basis of future action, the application of any general principles by no means easy. The particular crop, which happens to be the most profitable in a particular epoch, the quantity of capital and labour which the crop may require, the topographical and climatic conditions, the degree of diversified farming in practice, the available facilities of capital and credit, etc.—all these may determine the size of the modal farm. Within the scope of these determinants, however, we may indicate here two principles which should guide us in fixing the upper and the lower limits of the required size. The upper limit is determind by the managerial capacity of the average farmer; it is here that Professor Carver's classification of the difficulties of large-scale agricultute—as seasonal geometrical, or temperamental—finds its relevant application. The lower limit is dictated by the necessity of giving the fullest employment to the most essential and indivisible factor of production which, by general consent, is recognized as the peasant and his family.

Land Legislation

An effort to eliminate this evil was made in Bombay but unfortunately the bill did not commend itsely to the legislative

council of those days. It will serve a useful purpose in these days of large schemes to recall the main features of this well deserving but ill-starred attempt at legislation.

The first part of the bill was directed against the creation of any new fragments. It prohibited the cultivation of new fragments and required the lease or transfer of them to be made—if at all—to a neighbouring cultivator. In case of a partition, which might involve in other circumstances an uneconomic sub-division, the other claimants were to be compensated. In the case of old fragments, while their cultivation by the owners was not barred, the contiguous neighbour was given a right of pre-emption, whether of lease, sale, etc., for a period of one year. It was also provided that in case of disagreement on the terms, no transfer could take place. The Government undertook to advance Tagai loans for purposes of purchase and compensation and also to exempt documents relating to such leases and transfers from stamp duty and registration fees.

The basic unit of production assumed in this bill was to be determined for each of the several tracts or districts by a committee consisting of the Collector, the Deputy Director of Agriculture, and three representatives of the District Local Board, subject to an appeal to the Divisional Commissioner.

Perhaps the only serious omission which could be urged against this part was the absence of any regular machinery to determine the prices or terms of lease, transfer and compensation. But with the ample records of sale etc. in our Government Offices, it ought to be found very easy to supply the deficiency.

The second part was intended to achieve consolidation of scattered holdings. A majority of two-thirds of the interested owners was required to compel the recalcitrant minority; and the valuation of existing rights and the apportionment of the consolidated lands were entrusted to a special officer, subject to the check of appeal to a tribunal of a judicial character. The Government undertook to remit half the revenue assessment, to advance Tagai loans, and to exempt the relevant documents from stamp duty and registration fees.

Perhaps the presence of some clauses to discourage the formation of too large estates on the lines devised in other countries might have served to disabuse the public mind of one

not quite well-founded misconception. An indication of general principles, on the lines of which the standard unit of cultivation was to be fixed, would have deprived the opposition of one powerful line of argument. Perhaps, in these days of more prosperous finance, it may yet be possible to offer much more solid financial inducements so as to sweep away the prejudices and the opposition to the measure in no distant future. In the meanwhile, permissive legislation with some financial concessions and taxable penalties and manipulations may go a long way to prepare the public mind for the great change.

Scope for Capitalist Farming

While co-operative farming deserves to be encouraged, it should not be found impossible to combine the essence of such co-operation with the efficacy and productiveness of capitalist farming. It is possible to apply the principle of joint-stock companies to agriculture without weakening or impairing the ties which bind our rural population to land. Where a joint-stock company is willing to undertake cultivation, the power of law may be allowed to be invoked to acquire on lease the farming land on which it is to operate. While the existing cultivators acquire the status of landlord towards the company and might also be raised to be profit-sharers by statute, the company on its part should accept the obligation to employ them on its lands and provide for them, with or without the assistance of the State, the essential amenities of such employment. It is probable that such capitalist farming and obligatory employment are feasible only for crops like sugar-cane or oils-eeds which permit a combination of factory and field in the same area. Even if such farming were limited to non-food crops, the area could be large enough to influence the level of general agricultural efficiency and national income in an appreciable manner. If joint-stock companies of this type do not attract private initiative, particularly in the earlier stages, the State might be well advised to offer direct inducements for the purpose like guarantee of return for specific periods. The Plan before us, it must be stressed, is one for a controlled economy and not planned economy. It aims at prescribing the lines along which development should take place by the main device of prohibiting

other alternative lines. It does not propose to alter, except for certain well-recognized and accepted purposes, the ownership or immediate control of factors of production. In other words, competition as the motive force of the economic system is not to be suspended. Within each industry for which capital will be allowed or made available, the units of production will still be based on private initiative and enterprise which will still be responsible for decisions as to methods, scale, and, above all, location of production. Special interference and restrictions will still have to be justified by special privilege or public interests.

On the industrial side, it should not be difficult to adjust the plan in such a way as to allay fears about the fate of agriculture in the final outcome. In the order of execution, priority could be—and should be—given to those industries which enhance the productivity and profitability of agriculture. The manufacturing of implements and manures, the creation of wells and irrigation facilities, etc. fall naturally under the head 'agricultural productivity'. The finishing and processing of agricultural produce, transport in the economic, no less than physical sense, the supply of power to rural areas, etc. represent other industries which subserve mainly the cause of agriculture. All the industries taken in the aggregate will require investment on a scale sufficient to absorb the bulk of available resources.

Industrial Capitalism under the Plan

In the minds of many critics, the industrialization part of the Plan appears to have conjured up a veritable paradise of easy and limitless profits. Such a view of the Plan overlooks some important points involved in its execution. In the first place, industries will come into existence only on the basis of certain agreed priority of capital issues which, on account of their concentration on certain lines, will hold out but moderate prospects of profits. National requirements and not profitability will decide which industries will receive the necessary capital and resources. Secondly, even when high profits accrue, the bulk of them will certainly be intercepted by taxation maintained at a very high level. It it a complete misunderstanding of the scheme to imagine that the present war level of taxation can be allowed to fall under a scheme of development like the one under

contemplation. Education, medical facilities, housing and other amenities will call for a scale of current expenditure much beyond the expectations of the critics. Thirdly, even when high incomes percolate into the hands of individuals, they will find that, under an effective system of rationing and price-control, excess incomes have only one use and that is, reinvestment. In the last resort, a radical reconstruction of company law and limitation of profits could always be invoked, but very probably such measures could well wait until the whole Plan gathered speed and momentum.

In their schemes of transport and irrigation works generally the authors have ignored, in an unaccountable manner, the whole subject of inland navigation by water. The relative efficiency of different factors of production and, therefore, the relative suitability of different industries for different areas and for the country as a whole is not a question of mere physical abundance or scarcity, The economy with which the factos can be brought together and their products conveyed to the markets is more often than not the basic influence which shapes each industrial structure. The economic history of more than one country demonstrates to the hilt how natural resources remain economic resources only in the potential sense until cheap transport links them and alters the whole structure of relative costs. Among the means of cheap transport, waterways have yet to meet an effective rival. In India, waterways are linked inseparably with irrigation works—one of the main supports of its agricultural economy.

CHAPTER IV

STABILIZATION OF AGRICULTURAL PRICES

Agriculture has passed recently through a phase of unprecedented distress and is passing now through a phase of remarkable prosperity, the cause in both cases being steep changes in price-levels. In the rapid deflation which succeeded the 1929 crisis, the prices of agricultural produce collapsed at a rate which turned the ratio of exchange to an unparallelled extent against the agricultural producer. Thanks to the inflation during the War, the recovery which was already taking place was transformed in a short time into an era of unusual profits for most crops. It is hardly surprising that with the memory of the bad years of depression and the present prosperity in mind, the agricultural class generally has begun to place or seek its salvation in a stabilization of prices somewhere round the present levels. With the acceptance of this idea in the Bombay Plan, it may be said that such stabilization has become almost an article of national economic faith.

Stabilization and Costs

The plea for stabilization of agricultural prices usually springs from a belief that the costs of production in agriculture are more or less rigid, particularly under a system of peasant proprietorship. This belief, it is to be feared, overlooks one or two important facts. For the peasant, the most important element of cost is his own labour—in other words, the maintenance of himself and his family. The actual burden of this cost is determined by two sets of influences. If he is largely or entirely a grower of the food he consumes—and this is true of the bulk of our peasantry—a large part of his cost or expenditure is outside the reach of any changes in prices. But agricultural produce consists of a large variety of commodities, food and non-food. If the peasant grows crops other than the staple food of his consumption, his concern in the relationship of the prices of crops he cultivates to the prices of his staple food is no less keen than in any general stabilization of prices. If the peasant depends only partly on farming as his source of income and

Prices—Wholesale, Agricultual & Manufactures.

	1921	1922	1923	1924	1925	1926	1927	1928	1929
Prices of agricultural products (1914 = 100)	156	156	140	150	152	138	131	128	133
Prices of manufactured products (1914 = 100)	219	195	193	211	193	169	151	137	—
Ratio of prices of manufactured products to agricultured products	140	151	138	141	126	122	115	106	—

	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939
Wholesale prices—1st Quarter (Calcutta, July 1914 = 100)	—	127	99	96	85	89	—	91	99	98	97
Prices of agricultural products—March (July 1914 = 100)	139	112	84	69	64	77	75	83	94	—	—
Ratio of wholesale to agricultural prices	—	113	117	138	132	115	—	108	105	—	—
Wholesale prices—3rd Quarter (Calcutta July 1914 = 100)	143	113	92	88	90	89	90	91	104	95	105
Prices of agricultural products—September (July 1914 = 100)	119	90	69	70	72	74	79	84	—	—	—

		1939-40	1940-41	1941-42	1942-43	1943-44
Prices of agricultural products } Aug. 1934 = 100	Food,	118	107	122	172	294
	Non-food	157	113	129	157	219
Prices of manufactured products		131	120	154	190	251

receives the balance of his income from some other source like labour, his concern for food-prices is enhanced still further. If the prices of different agricultural products were as a rule to move together or at least diverge only insignificantly from each other, this difficulty would not exist. But no scheme of stabilization seriously put forward till now holds out any assurance of maintaining the same or approximately the same relative prices among different agricultural produce.

In the second place, the real burden of this cost depends not on the absolute price the peasant receives for his produce, but this price relatively to the prices of non-agricultural goods he has to buy. Even if the price of his own produce remained stable, a rise in the prices of non-agricultural goods will deprive him of a part of the benefit of price stabilization. Price stabilization will be a genuine boon only if the prices of other goods were assumed to remain stable or to fall.

When rigidity of costs is alleged in agriculture, the monetary outgoings of the cultivator in view are land revenue, interest and repayment of capital, rent, etc. Where land is owned by the cultivator himself or rent is paid as a fraction of the produce, money rent ceases to be a factor in the situation. Even in those cases where all these elements have to be reckoned with, it is doubtful whether they outweigh in the aggregate the remuneration of the peasant's labour. It may be conceded, however, that in so far as a policy of general stabilization stabilizes the prices of particular agricultural commodities, the burden of these costs is made relatively easy to bear.

Control of Supply

If price stabilization were agreed on as a desirable goal, the next question would be to devise the appropriate means to achieve the objective. This involves as a matter of course the analysis of causes which tend to make the prices received by the cultivator low rather than high. In suggesting remedies to counteract these causes, the wider consequences of such price stabilization must necessarily occupy a good deal of our attention.

It is sometimes regarded as a serious loss to the cultivator that the whole output of his crop falls into his hands at the close of the season and in the absence of storing and other

facilities, has to be thrown on the market in a single instalment. This would be true only if the price ultimately paid by the consumer exceeds the price received by the cultivator by more than the expenses of storage, insurance against loss and deterioration, interest, transport and the labour of distribution, etc. It is quite true that many avoidable causes and practices operate in India to intercept a part of the legitimate dues of the agriculturist. But it is equally true that there is a tendency to underestimate or overlook the costs enumerated just now. As for the questionable inroads on the dues of the cultivator, the proper remedy would be to make our laws on the subject of marketing more drastic than they are at present and their administration more effective or efficient and to weed out ruthlessly all unnecessary intermediate agencies whether by co-operative marketing or otherwise.

Of much greater effect than the seasonal factor, are the arbitrary variations in the output caused by climatic conditions. Not a little of the improvidence or unbusinesslike character of the peasant all the world over is ultimately traceable to these unforeseeable fluctuations in his economic life which consist of alternating cycles of profits and losses. It would be a great gain economically and psychologically if these heavy swings in the peasant's life were replaced with a more even course of moderate but stable earnings. The remedy which suggests itself most readily is an arrangement by which the surplus of bountiful years is carried over into the less bountiful years. But even if the problems of investible funds, storage facilities, technical personnel, etc. were satisfactorily met, it has to be recognized that this remedy has its limit in the liability of all agricultural produce to deteriorate with the passage of time.

This brings us to the possibility of adjusting the output itself to the prospects of prices obtainable in the market. Leaving out the climatic factor as unamenable to human control and liable to frustrate the best schemes and policies, we have still to deal with two major factors influencing prices, namely, the acreage under cultivation and the fraction of the output held back by the cultivator for his own use. The control of acreage by administrative action or financial inducement has become a familiar experience of the war economy and might

become an instrument in the hands of a planned economy to secure the supplies of agricultural goods in certain proportions. But it must be recognized clearly that the control of acreage to stabilize prices is quite different from the control under a planned economy to assure the requisite supplies of certain commodities. The former aims at the maximization of the sale proceeds or gross income by taking care that the increase in output stops short at the point at which price is likely to fall more than in proportion. In the latter case, on the contrary, the acreage prescribed under each crop has no reference to the profit of the individual cultivator, but is dictated by social priorities. With more accurate statistics of output and market conditions, it should not be impossible to correct the abundance of one season by deliberate curtailment in the next and thus overcome the difficulty of deterioration on account of accumulation over too long a span of time.

The other factor, namely the tendency of the peasant to hold back a smaller or larger fraction of his output, particularly food-crops, for his own use operates and is the cause of a perverse elasticity of supply only because of extreme instability of prices. When prices of food-grains are very high the peasant finds it sufficient to offer only a small fraction of his output to secure his non-agricultural requirements and is apt to increase his personal consumption. On the other hand, when prices are low, he is apt to depress them still further by offering a larger fraction of his output in order to cover his other needs. If prices of agricultural produce were stabilized, it is probable that the consumption of the peasant will become more stable and his market supplies less variable, provided of course prices of non-agricultural commodities themselves prove not too unstable.*

International Implications

Any scheme of adjusting output with a view to maintaining prices cannot overlook the fact that in the case of some agricultural produce at least, this country cannot function as a closed economy but only as a part of world economy. In the case of some

* D. S. Sastri: (*Advance Against Goods*, Thacker & Co.) estimates the output retained in villages as 50 p. c. for rice & 60 p. c. for wheat.

products which are produced or consumed locally, it may possible within broad limits to maintain prices in this manner. But some of our most important staples like cotton, wheat, oilseeds, etc., depend for a good part of their markets on foreign countries and in the absence of special remedial arrangements, must lie at the mercy of international prices. In assessing the bearing of this international factor on the fortunes of our cultivators, we must, however, distinguish between cases in which the interests of different agricultural countries are alike and others in which interests diverge and each country must perforce adopt its own protective measures. When climatic or acreage factors cause harmful variations in output, it is clearly in the interests of the agricultural classes of all countries that international co-operation should be invoked to prevent such maladjustments of supplies. Similarly, if agricultural efficiency and improvements advance equally in all countries and the increase in output does not bring about a more than proportionate fall in prices, the interests of all classes, producers and consumers alike, are well served by the progress. Difficulty is caused when the capacity to consume is not able to keep pace with efficiency of production and the fall in price is out of proportion to the increase in output. In this particular circumstance, the aggregate income of the agricultural classes must suffer a sharp decline to the advantage perhaps of the non-agricultural classes. The remedy in this case would again lie in controlling acreage with the object of slowing down or regulating the speed of improvements until such time as demand is able to catch up with increased efficiency. The most difficult and perhaps more common situation arises when improvements and efficiency cannot in the nature of things advance equally in all agricultural countries. This disparity of progress is apt to arise between countries under peasant proprietorship and others under large-scale or capitalistic farming. While the latter find more or less full compensation for the fall of prices in their increase of output, the peasant proprietors have more often than not to bear the full weight of diminished values. This was perhaps what happened to the Indian peasant after the last Great War and particularly the great crisis of 1929. One remedy for such a situation would be to establish a complete control or monopoly

of foreign trade in these staples and allow discriminating prices to prevail between the domestic and the foreign consumer. But such a solution of this difficulty must mean difficulties for such of our industries as use these staples as their raw materials and have to export a part of their manufactures. Such exports will have to be subsidized to the extent of the difference between domestic and foreign prices of raw materials—which means, of course, a burden on the generel tax-payer, particularly the business and professional classes for the benefit of the agricultural classes.

Finally, account has to be taken of those cyclical or secular changes in prices which affect all parts of the economic system. Agriculture is, however, apt to suffer much more in such times as spatial difficulties of combination, numerousness of producers, etc., makes them incapabe of controlling the aggregate supplies in the market. For this reason, agriculture is much more interested in any general economic or monetary policies which are likely to avoid these fluctuations. But if cyclical or secular changes must persist, it becomes necessary to devise measures to mitigate their special impacts on agriculture. Compulsory or voluntary reduction of agricultural output has sometimes been suggested and even practised as a means to restore the parity of values between agricultural and non-agricultural output. But reduction of output, particularly of food, in a phase of depression is hardly to be commended as a socially desirable policy. The only other alternative would be to subsidize agricultural production, that is, transfer incomes by means of taxation from agricultural to non-agricultural classes. In a country like India, special remissions of land revenue to owner cultivators counterbalanced by special taxation of non-agricultural incomes offer a particularly convenient means for such transfer of burdens. In going to the succour of agriculture, however, proper regard must be given to the changes in the relative values of agricultural and non-agricultural goods and also any changes which may have occurred in their relative costs of production. If technological advance is unequal in the two lines of production, care will have to be taken that ill-advised subsidies do not create a profit inflation in the more progressive lines.

CHAPTER V

THE INVESTMENT MARKET IN 1944

Pre-war Prices (1939)

	Lowest	Highest
Tata Deferreds	840	1560
Tata Ordinary	205	334
Bombay Dyeings	696	1195
Centuries	191	436
Kohinoor	201	472
Associated Cements	103	136
Howrah	48	65
Anglo-India	288½	396
Patracola	790	940
Gungaram	302	365
Kalpetta	11	21¼
Peermade	21¾	25½

During the closing year, the stock exchanges were confronted with the task of adjusting themselves to quite fundamental changes or prospects of fundamental changes in the economic situation. In the earlier half of the year, investment values were largely and inevitably at the mercy of the varying fortunes of military operations. In the latter half of the year, since the collapse of German resistance in France and the attempt on the life of Hitler, the exchanges have been seeking, in accordance with every fluctuation in expectations, levels more appropriate to the probable economic trends of peace. Within the scope of these broad and overrulling influences, incidents of economic policy or those special to individual scrips or sections of the market have been neither few nor insignificant. The taxation and financial policy of the Indian Government, the many administrative controls and interferences relating to the textile industry, the gold and silver policy or rather lack of policy of the Reserve Bank, precautionary reductions in dividends in anticipation of peace, etc., have in the aggregate proved much more potent factors than the usual, unavoidable spates of rumours, inferences, half-truths and false-

hoods which in many cases are after all efforts at intelligent anticipation.

With the unprecedented inflation of currency during the previous twelve months and the expectation of unprecedented dividends in the near future, the opening of the new year found the stock exchanges stoutly declining to allow their optimism to be over-clouded by the premature shadows of the inevitable budget, now only two months ahead. The markets moved up in an unbroken curve till, about the first week-end of February, *Tata Deferreds* raised themselves from the opening year level of Rs. 1,960 to Rs. 2,170; *Ordinaries* from Rs. 396 to Rs. 430; *Dyeings* from Rs. 2,050 to Rs. 2,170; *Centuries* from Rs. 890 to Rs. 1,175; and *Kohinoors* from Rs. 640 to Rs. 730. The precautionary tendency to seek shelter in the protected asylum of Indian States from the dimly apprehended swoop of the Indian Finance Member did not find much expression in the prices of Indian State scrips as most of them had already reached very high levels by the close of the previous year. In the textile group, *Osmanshahis* crawled from Rs. 360 to Rs. 376; *Raza Textiles* from Rs. 100 to Rs. 121, while *Azamjahis* hesitated about the level of Rs. 655–700. The only exception was the spectacular rise of the ordinarily quiet *Minervas* from the opening year level of Rs. 225 to Rs. 327 by the first week of February.

After the first settlement day of February, however, the approach of the budget began to cast its shadows on the opening optimism of the year. From the peak levels of February 8, the eve of the budget recorded a fall in *Deferreds* of about Rs. 100; *Ordinaries* of about Rs. 25; *Dyeings* of about Rs. 100; *Centuries* of about Rs. 75; and even in *Associated Cements* of about Rs. 2. Indian State scrips kept very steady by contrast. Although the market was in practically full possession of budget proposals on the eve of the budget day, the first reaction on the D-day itself was one of rather hesitant decline as if the market found difficulty in grasping the full implications of the proposed immobilization of excess profits after payment of E.P.T., compulsory deposit and other income taxes. On the second day, however, the scrips of companies with standard years of low profits recorded precipitous falls while steels, cements, jutes, Indian State scrips, certain textile companies whose standard

years were good, declined but slightly or were quite steady. In less than a week, the realization that the immobilized profits must tend to strengthen the post-war position of all concerns appears to have enabled the market to recover its buoyancy and till the third settlement day of March, all scrips advanced rapidly, steels giving a spectacular lead. *Deferreds* which had reached a pre-budget low level of Rs. 2,060 advanced to Rs. 2,250 and *Ordinaries* from Rs. 408 to Rs. 430. *Dyeings* improved by about Rs. 100, *Centuries* by about Rs. 75 and *Kohinoors* by about Rs. 30, although these were still unable to make good their total pre-budget and post-budget deterioration.

This contagious optimism of the market was suddenly disturbed and destroyed when the third week of March brought the news of the appearance of the Japanese army on the Indian soil. By the time of the second settlement of April, *Deferreds* collapsed from the high level of Rs 2,250 to Rs. 1,967 and *Ordinaries* from Rs. 428 to Rs. 388. During the same interval, *Dyeings* lost more than Rs. 100 and *Centuries* Rs 60. Even Indian State scrips showed substantial losses. On the Calcutta market jutes, which had till now shown stolid steadiness except for adverse reaction to the budget, fell in a substantial manner, *Howrahs* losing Rs. 10, and *Anglo-Indias* about Rs. 30.

Towards the second settlement of April, when prices were about to take their second and bigger plunge, the pre-requisites of an active market were once more seen in conflict with attempted control of its technique by Government when the authorities of the stock exchange issued a severe warning on the illegality of *budla* transactions. It is quite clear that where sellers and buyers are agreeable and have a status and reputation to maintain, prohibition of *budla* within the ring must remain at best a dead letter. Secondly, it has to be remembered that the *budla* is nothing more than a penalty interest which, according to the technical situation of the market should impel the buyer or seller to close the transaction rather than carry it over from week to week. Finally, it is an elementary principle of exchange value that fewer and more ill-balanced the buyers and sellers, the larger is the number of possible points of equilibrium and greater the fluctuations in

demand or supply. Because of their long and intimate experience of the market, the large fringe of the crowd which trades on differences is really an important factor in widening the multilateral basis of the market and making values continuous and stable.

With the absence of further bad news from the Burma Front, the military factor began to recede into the background from the third week-end of April to give fuller scope to economic factors. From this time onward, however, steel and textile sections parted company till German reverses in France and the attempt on Hitler's life involved them in a common relapse. Between the second settlement of April and the third settlement of July, expectations of high dividends and periodic rumours of higher and higher rates of conversion of *Deferreds* into *Ordinaries* led to more and more acquisition of *Deferreds* till their value rose from Rs. 1,967 to above Rs. 2,300, while *Ordinaries* staged a sympathetic rise from Rs. 390 to Rs. 430. The withdrawal of Japanese forces from India about the end of May and early June reinforced the upward trend in a marked manner. In constrast with the buoyancy of steels, textiles appear to have fallen on evil days. As the Textile Control Board got more and more busy, issued and threatened successive price reductions and, in extreme cases, took over direct management of offending mills, the gathering pessimism about dividend prospects weighed down the price of textile scrips more and more. Particularly severe falls were experienced in the third weeks of April and July. In the upshot, despite minor recoveries, *Dyeings* climbed down slowly from Rs. 2,050 to Rs. 1,900, *Centuries* from Rs. 1,000 to about Rs. 900 and *Kohinoors* from about Rs. 680 to Rs. 630. Even Indilan State textile scrips exhibited an uneasy downward trend.

While the successful invasion of France in June and the earlier military successes imparted an actual buoyancy to the market at first, the attempt on Hitler's life during the third week of July caused moderate uneasiness over the prospects of an earlier peace and perceptible falls in almost all scrips. Steels, however, resisted the earlier falls on rumours of unusual dividends and bulls took full advantage of the opportunity to raise *Deferreds* to more than Rs. 2,300 while *Ordinaries* just recovered

lost ground. By the third week of August, the rapid advance of Anglo-American arms and the optimistic speeches of Allied leaders and commanders initiated a peace panic and rapid relapse all round. From that week to the first settlement of September, *Deferreds*, now quoted ex-dividend at about Rs. 2,200, lost about Rs. 200; *Ordinaries*, quoted ex-dividend at about Rs. 405, about Rs. 25. The collapse of textiles already serious on account of the military factor was much aggravated by a short fall in the expected dividend of Bombay *Dyeings* by Rs. 10. *Dyeings* fell in the aggregate by about Rs. 200, *Centuries* by about Rs. 150, *Kohinoors* by Rs. 100, *Osmanshahis* and *Azamjahis* by Rs. 60; *Raza Textiles* by about 25. *Associated Cements* which had actually improved in the earlier phase of general relapse by about Rs. 25, no doubt as a post-war investment, was struck about this time by the unpromising results of the rival Dalmia concerns and fell from Rs. 238 to as low as Rs. 219. Even plantations which throughout the whole year had maintained and slightly improved their values succumbed to the general trend. In the south, *Kalpettas* went down from Rs. 50–52 to Rs. 41 and *Peermades* from Rs. 54 to Rs. 49. In the North-East, *Patracolas* lost about Rs. 20 and *Gungarams* Rs. 5. Jutes, another generally accepted post-war investment, kept very steady.

By the first settlement of September, the confidence in the early advent of peace began to give way to doubts about an indefinite prolongation of the conflict. This change of sentiment and perhaps the reflection that the war with Japan must in any case outlast by some months if not years the war in Europe, found expression in a marked and steady improvement of cotton textiles which had met with a special recoil from the adventitious announcement of a fall of Rs. 10 in the interim dividend of *Bombay Dyeings.* From September 8 to the second week of December, *Dyeings* advanced steadily from Rs. 1,700 to Rs. 1,860; *Centuries* from Rs. 750 to Rs. 840; *Kohinoors* from Rs. 540 to Rs. 620. Indian State scrips shared in the general trend, while *Associated Cements* flared up from Rs. 219 to Rs. 247 on rumours of some specical expectations.

The course of steels which has much to fear from the advent of peace in Europe and little to hope from a prolonga-

tion of the conflict in the Pacific was different. For about one month from the first settlement of September the market improved at first and then values rose and fell within a narrow range of about Rs. 50 for *Deferreds* and Rs. 10 for *Ordinaries*, as if the market was unable to adopt any particular view. From the first settlement of November, however, under the influence of a few bold spirits who voted for a long war, *Deferreds* were raised rapidly to a hectic level of Rs. 2,280 from Rs. 2,050 and *Ordinaries* to Rs. 420 from Rs. 370.

As the year is at its close, the market is trying to resolve certain doubts which have crept over it. How will the military reverses of China influence the military prospects on the frontiers of India? To what extent are the buyers prepared to leave their position open over the year-end holidays? To what extent will certain banks withdraw their funds in order to present a strong balance-sheet on the New Year day?

Control of Speculation

This account of events in 1944 establishes one fact clearly. In the absence of new issues and alternative outlets for investment, the inflation of currency and incomes have expressed themselves in a certain basic level for each scrip round which actual values fluctuate according to military prospects within more or less definite ranges. According to the basic price and degree of activity and speculation of each scrip, the range is as great as Rs. 400 (*Deferreds*) or Rs. 300 (*Dyeings*) or as low as Rs. 30 (*A.C.C.'s*) or Rs. 20 (*Howrahs*), etc. The close of the year finds the market unwilling to anticipate peace unless peace presents itself as an unavoidable fact and is on the whole adjusted to an indefinite prolongation of hostilities. Any early and sudden descent of peace must find the market in an unenviable situation. It would ameliorate conditions if Government found its way to permitting new issues on a fast rising scale and relax progressively restrictions on other forms of investment. It is also much to be feared that some of the more recently created banks, unable to find much scope for loans and advances of the safer variety, have tried to earn or maintain profits by placing their funds to an imprudent degree in the stock exchanges. Among the many controls which the Government has attempted under

'the special conditions of war, enforcement of drastic margins for loans against stock exchange securities should have found a place long ago. The protection of investors and safety of banks no less than a joltless transition from war to peace conditions are likely to be safe-guarded more effectively by this means than by some of their more doubtful interferences with the market technique.

Investment Yields

Since prices have fluctuated over a wide range and inflation of prices and dividends has run a parallel course, absolute yield percentages do not hold out more than a strictly limited significance. But relative yields are more instructive as recording the market's appraisal of individual quality and possibilities of the near and distant future. In the following remarks, the calculations are based on prices as they stood at about the time of the declaration of dividends and when on the whole they represented the inflated phase. Among cotton textiles, the most highly rated shares offered a yield nearer 5 than 4 per cent, while medium quality scrips which account for the bulk yielded 5 to 7 per cent, approaching more often than not the higher limit. As may be expected, plantations as a class, stood out by their large yields, a fall below 8 per cent being the exception. Banks as a non-speculative investment hovered round the gilt-edged yield of 3½ per cent., while steels and engineering scrips varied their outturn between 4½ and 5 per cent. Coal yields as a rule maintained the poorest levels at about 2 to 3 per cent. Among jutes, another post-war scrip, a yield of more than 5 per cent as in the case of *Howrahs* was a fortunate exception, the common outturn being less than 3 per cent.

CHAPTER VI

THE INVESTMENT MARKET : RE-ORGANIZATION

The capital and investment market of 1944, was dominated more or less entirely by abnormal factors like military events, investment controls and prohibitions, price controls, etc., and as such can hardly furnish much guidance to the more permanent problems of peace and reconstruction. For the latter purpose, we must fall back very largely on our experience of the past and this experience establishes very clearly that the main deficiencies of the market are three, namely, the staggering waste of mistaken or incompetent promotion; high instability of values and consequent deterrence to genuine investors; and finally, the tendency to waves of over-investment and under-investment with their serious reactions on production and employment. It is true that the general, uninstructed public is apt to think of this market more in terms of frauds and malpractices than any technical deficiencies, but it will be found on deeper reflection that these evils are largely traceable to the three defects already stated. It follows therefore that improvement and reform for the future must consist very largely of moderation or elimination of these defects.

Ultimately, indeed, these defects themselves proceed from the fact that the whole mechanism of the market rests on the foundation of individual judgement and investment enterprise. It is true that expert and highly specialized intermediaries—the brokers—exist to offer guidance to the investing public. But experience proves conclusively that their existence does not modify in any substantial manner the inherent drawbacks and weaknesses of individual judgement which more often than not is apt to be lay and uninstructed judgement. In other words, the drawbacks and weaknesses of the investor's judgement constitute the real basic problem of the capital and investment market and the main direction of reform must be to find effective means to protect the investor against himself.

Potentialities of Investment Trusts

The growth of insurance in recent times is very suggestive and offers instructive precedents for such protection. What

insurance companies achieve in the field of protection against the uncertainties of life, investment trusts whether of the general, fixed, or unit type, could achieve with equal effectiveness in the field of protection against the uncertainties of investment. For the fulfilment of this purpose, two fundamental changes will have to be effected. Individuals should be legally debarred from subscribing to or holding the shares and stocks of individual enterprises, all contributions to capital in future being allowed only through investment trusts. Secondly, as in the case of insurance companies, the investment of funds by these trusts should be regulated by law. To illustrate the point, it may be suggested that investment trusts should be compelled to hold a quarter of their funds in a widely defined class of gilt-edged securities, another quarter in preference shares and debentures while the balance may be left free to be directed if desired into new or more venturesome channels. A fractional regulation of this kind should as a logical consequence imply a minimum paid-up capital below which no trust should be allowed to operate.

It might appear that the greatest difficulty of such a plan will be how to deal with existing holdings of scrips and their owners. No commandeering or confiscation is possible or indeed desirable or even necessary. It would be enough if individuals are merely precluded from acquiring new issues in the future. The process of time may well be trusted to bring about a steady, but certain transfer of all scrips into the possession of investment trusts until at some future date the prohibition is made absolute.

Under this arrangement, it is clear that the individual is not altogether relieved of the need to exercise his judgement or enterprise. Investment trusts are bound to differ in quality, efficiency and results and the individual will still have to make a choice of particular investment trusts. Similarly, the stock exchanges with their membership of specialized brokers need suffer no diminution of their business. For the general public, they will deal in shares and scrips of investment trusts. On behalf of the trusts themselves, they will have much business in the scrips of individual companies.

Apart from the diminution or elimination of the risks and uncertainties of investment, an investment organization of this

kind is well suited to deal with the evils mentioned above. With their skill and experience of dealing in varied scrips, investment trusts should find it easy to develop the necessary technical and other means for participation in new or untried ventures. Their holdings of large fractions of the fixed capital of productive enterprises will give them sufficient power and representation in the management of the business of the country. Trusts of this kind rather than industrial banks, as suggested by some, offer a more promising solution of the vexed problem of supply of long-term or medium-term capital to industry.

As for the regularity of the flow of investment, such an institutional structure will decidedly simplify the whole problem. Whether this responsibility is entrusted to an independent authority or, as appears more logical and indeed inevitable, to the Central Bank, the existing economic structure presents the authority with a baffling problem. The authority is pratically invited to sit in judgement not only on the aggregate desirable volume of investment at any time—which by itself is no easy task—but also on the relative claims of a myriad branches of investment and production which presupposes almost omniscience. If the authority is relieved of the latter almost impossible responsibility, it will be free to concentrate its attention on the one aspect which needs to be dealt with effectively. By licensing investment trusts, it will influence the aggregate volume of investment while the trusts themselves will discharge the delicate and difficult responsibility of judging profitability in each individual case.

Under the structure of investment contemplated above, there will be two sets of values on the stock exchanges. The general public will be concerned with the values of trust shares alone. With the averaging of the risks of business and industrial dividends, these values should exhibit a much higher degree of stability than what the individual investor is confronted with today. The second set of values, namely, the values of industrial scrips with which the trusts alone will be concerned, deserve a closer scrutiny. This market will be constituted of a few and powerful buyers and sellers who, it might appear, will be able to rock and sway the market to an undesirable extent. To forestall this possibility, we have only to detect the prime

motive and adopt effective means to suppress it. It is clear that if the directors and managers of investment trusts are allowed to abstract the profits of speculation, the temptation to use trust funds for mere gambling will be very high. A simple and effective remedy for this would be to make it legally obligatory that the scrips held in investment trusts should be lodged with recognized banks in trusteeship, every change in holdings and authenticated prices of sales and purchases should be recorded in the books of the bank, and finally, the profits of the turnover of scrips, i.e. capital appreciation, must be added to the reserve of the trusts and not distributed as dividends. With these safe-guards, a few but well-balanced and well-informed buyers and sellers should contribute rather to stability of values than otherwise.

Possible Objections

Our thesis is not complete unless we consider main possible objections and possibilities of abuse. In the first place, we must consider the position of directors of companies under an arrangement of this kind. At present, most directors have a double interest in the management of enterprises. As office-bearers, they receive their fees for attendance and supervision. Under the scheme contemplated by us, this source of income is in no way affected. More often than not, however, directors as individuals seek benefit as investors from the companies they manage. Under our proposals, directors can have no holdings in their companies except indirectly through the scrips of investment trusts. It may be asked how in such circumstances people can be expected to offer themselves as directors. The answer is two-fold. It is no merit, but a well-known evil of the present system that directors with their inside knowledge are able to manipulate directly or through their nominees the shares of the companies they manage. Secondly, it is always possible to secure the best available talent by the offer of adequate fees and open ways of remuneration.

It is likely that the prohibition of direct investment will stimulate the multiplication of private limited companies in the field of investment trusts. But so long as identical restrictions are enforced on public and private companies alike, such a

development need not impair the general object in view.

It is possible that those who seek capital for particular wild cat or reckless enterprises may abuse the object of investment trusts by raising capital sufficient to leave a margin above the legal minimum for their own purposes. Under the illustrative regulation indicated above, a dishonest or reckless gang of promoters could raise 20 lakhs for their own enterprise by floating a trust with a paid-up capital of 40 lakhs. Such a possibility of abuse and evasion could be materially diminished if not suppressed by the enforcement of a rule that not more than one-tenth of the free surplus above the legal minimum may be invested in a single scrip. Many investment trusts are known even now to incorporate voluntarily such restrictions on their powers in the articles of association. True, this will have in practice the effect of provoking people of the class under review to raise the paid-up capital of investment trusts still higher. But the higher the capital requirements, the less possible is it for questionable or obscure people to abuse public ignorance and credulity.

The inter-position of an additional intermediary cannot but add to the cost of investment borne by the public. To the present cost of stock exchange services, the investment trusts will add their own working and administrative expenses. But compared with the benefits which will ensue and the evils which will be avoided, this cost will be hardly significant. The working expenses of three or four well-managed and well-known investment trusts in existence at present do not aggregate to more than ·64 to ·75 per cent of their paid-up capital and 11 to 15 per cent of their gross income. In the case of one trust whose managing agents have exacted for themselves as favourable terms as possible, the percentages are as high 4·0 and 30·0. The lower fractions of the better-managed trusts are themselves rather high as compared with the corresponding figures in the United Kingdom or the United States. This only means that the legal regulation of trusts must not omit this important aspect of trusts from its purview.*

*These suggestions were made in an article four months ago. The Government of India has since set up an inquiry into the stock exchanges and issued a questionnaire of some sort.

RUPEE FINANCE DURING THE WAR (Figures in Crores)

	1 Balance of Trade in Merchandise of Br. India (excl. of re-exports)*	2 Sterling payment by H. M. Govt. (against War Expenditures Recoverable from Br. Govt. shown in brackets.)	3 Defence Capital Expenditure.	4 Revenue surplus + or deficit—	5 Total Rupee Finance to be met‡ (Columns 1+2+3+4)	6 Rupee Finance met from loans, i. e. Increase in Public Debt over previous year†	7 Rupee Finance met by issue of currency, i. e. Absorption of Notes & Rupee coin¶
1940–1	+29·93	43 (53)	—	– 6·5	79·4	+142	52·4
1941–2	+64·31	201 (194)	—	– 12·6	277·9	+103	159·6
1942–3	+77·18	310 (325)	52	–112·1	551·2	+263	306·8
1943–4	+80·35	355 (Re 392)	38 (Re)	– 92·4 (Re)	575·7	+ 96	262·1
Total	251·6	919	90	–223	1,484·2	604	780·9
1944–5	—	—(Bud. 443)		– 54·7 (Bud.)			

	*Sterling amounts utilized for Repatriation	‡ Total Govt. outlay on account of Defence exp., Defence capital exp., Exp. recoverable from Br. Govt.	†Increase in sterling holdings of Reserve Bank (i.e. total sterling purchased & sterling payments by H. M. Govt. minus Repatriation of Debt & other Sterling commitments)	¶Treasury Bills (Average amounts outstanding with public)
1940–1	89	—	2	26
1941–2	110	297.9	140	—
1942–3	160	592.6	227	—
1243–4	16	693.6 (Re)	434	122
Total	375	1,584.1	803	—

CHAPTER VII

MONEY AND CREDIT IN WAR AND PEACE ECONOMIES

The annual visible monetary savings and investment of India progressed at a rate of approximately Rs. 100 crores during the decade 1921-30. During the four years 1939-43, which excludes the great inflation year 1944, the accumulation rate appears to have reached Rs. 300 crores. While during the earlier years, precious metals claimed more than a third and the permanent public debt about a quarter of the annual savings, the war has enabled bank deposits and public loans to oust almost every other visible form of holding savings like precious metals, post office savings and certificates, scrips of joint-stock companies, insurance, etc. The public debt of India is now responsible for more than half of visible investment and bank deposits for more than a third.

Inflation or Loans?

The story of how this growth in the volume of monetary savings has taken place and how public debt and banks have appropriated five-sixths of those savings is very simple and may be told in non-technical language in the following manner. Between 1940-4, England and her allies purchased goods for use in or outside India to the monetary value of about Rs. 1,200 crores. During the same period, India also financed her war expenditure which was in excess of her revenues by more than Rs. 300 crores. Unable or unwilling to offer in return any goods or capital assets, the Allies could have paid for their purchases from individuals only by means of loans raised in India. Similarly, having exceeded its income resources, the Government of India could finance itself only by loans in the same manner. Actually, against the aggregate expenditure of more than Rs. 1,500 crores, the Government of India on whom fell the responsibility to find domestic finance for both the expenditures, could not raise public loans of more than about Rs. 600 crores. The Indian authorities met the situation by accepting the mere paper promises of England called the sterling holdings of the Reserve Bank of India to the extent of about Rs. 800 crores and issuing

currency notes against them to the extent of about Rs. 820 crores. As notes were issued from week to week and month to month, the rise of prices caused a simultaneous growth both in the value of Allied purchases and the need to issue more currency notes. The goods supplied to the Allies came ultimately out of the consumption of those people whose incomes fell in purchasing power on account of rise of prices. It was a forced loan from classes who could least afford it.

The rise of prices approximately in the proportion of 100 : 250 raised money incomes which in the ordinary course of things should have raised monetary savings in about the same proportion. But the rationing and price control of certain goods as they came into force for one commodity after another, no less than the non-availability of certain other goods curtailed ordinary opportunities of expenditure and thus reinforced the normal influences which create savings. The volume of savings tended thus to swell still further. At the same time, legal or administrative restrictions or prohibitions altered materially the normal channels into which the community directed its savings. New capital issues were licensed and imports of precious metals and house-building came practically to a standstill. The way was thus apparently cleared for canalization of all savings into bank deposits or public loans but for the fact that there were still pre-existing assets like land and the operation of heavy taxation, excess profits duty and above all black markets created a new rival to bank deposits and public loans, namely, currency hoards. The size of these hoards must in the aggregate reach impressive dimensions since against a rise in the note issue from less than Rs. 200 crores to about Rs. 1,000 crores, i.e. a five-fold increase, the prices of both controlled and uncontrolled commodities and capital assets have not risen by more than 2½ to 3 times the pre-war level.

Failure of Loan Finance

This inflationary procedure of war finance raises the question whether the failure to raise sufficient loans was unavoidable. During the more normal years, 1921-30, when prices on the whole were sagging and there were no prohibitions on capital issues and no cessation of imports of precious metals

or house-building, the public debt was growing at an average annual rate of about Rs. 25 crores. Precious metals and paid-up capital of joint-stock companies were absorbing on the average about Rs. 50 crores annually. In other words, at a much lower price level and without taking into account the much enlarged real national income during the thirties, these sources alone could have furnished Rs. 75 crores annually or Rs. 300 crores in four years. It is difficult to estimate the savings which were releasable from house-building which was then passing through a great boom. It is reasonable to suppose that investment in housing could not be much short of our annual consumption of precious metals. Thus against the price-inflated requirements of Rs. 1,500 crores, in four years of War, there is to be set our normal capacity to furnish without curtailment of necessary consumption an output of Rs. 400 to Rs. 500 crores which at war prices have to be valued at less than Rs. 1,000 crores.

Apart from the identification of the public mind with a cause, the most powerful inducement to attract savings into public loans is undoubtedly the interest rate offered. It appears that it was decided from the very first that the era of low interest rates amidst which the War started should be continued into the War itself, presumably in the interests of public borrowing. The decision by itself is not to be blamed, provided the implications of it were fully realized and translated into action. A particular level of interest rates for public borrowing is, however, appropriate and effective only when it is properly related to the returns on alternative investments. In England, for example, the war was made a successful 2 or 2½ per cent war only because wholesale rationing and price controls created a volume of enforced savings and over-all and drastic controls of profits and civilian output made alternative investments sufficiently unattractive. In India, rationing and price control arrived in a tardy and haphazard manner and could cover only a few commodities and, what is more important, only in a few bigger places. High income tax, super tax and excess profits duty introduced at a fairly early stage of the War appeared to hold down the profit level of trade and industry but with output uncontrolled and low rates for loans and advances, allowed as a matter of fact margins of profits twice and thrice as large

as in peace times. When at length the government awoke in the budget of 1944 to the need of more drastic steps, capital values had already doubled and trebled themselves. Moreover, land, the main outlet for investment in the rural areas, although growing more attractive with rise of prices of produce, remained altogether outside the range of the Central Government's power. While alternative investments acted in this manner as a magnet for public savings, low interest rates for public borrowings invited their own frustration by reducing the cost of liquidity and encouraging people to hoard resources in the from of currency notes and bank balances. It may, therefore, be truly said that the essential prerequisites of low interest rates were not adequately grasped and certainly were never fulfilled to the required degree in India. Whether the cause of the ultimate financial impasse is to be ascribed to the choice of a wrong financial policy or to administrative failure must depend on our judgement about the scope and potentialities of legal and administrative action in this country. In the abstract, the choice lay between over-all and effective controls or effective levels of interest rates for borrowing. In actual practice, since large sectors of the economic system were bound in any circumstances to lie outside the range of Government's power, the proper policy for financing the War should have been on the one hand to raise moderately the rates of interest and on the other to take whatever measures were available to restrict and curtail returns on alternative investment. As the present writer observed on the outbreak of the War, 'With a rigidly controlled foreign exchange market and a scale of relative demands furnished by a definite objective like the prosecution of War, interest rates in England have only a formal significance. With a largely uncontrolled economy like that of India, interest rates are a real and active force of regulation.'

Indeed, India seems destined to pass through a quixotic phase of financial experience. During the years of War when higher interest rates could have moderated the degree of necessary inflation by inducing the public to subscribe to public loans and investment such as was possible required no stimulus of this kind, the country got the blessing of low rates. When the requirements of full employment and rapid growth should

make in post-war years low rates very imperative, it is more than probable that higher rates will prevail in a struggle to hold in check the potential inflation implicit in hoarded currency and bank balances and, in the absence of a proper exchange policy, the trend to adverse trade balance implicit in an inflated price level. The pennies gained on the interest charge of public debt will have as their nemesis the pounds lost on the actual inflation of war years and the probable deflation of post-war years.

Repatriation of Sterling Balances—Implications

An issue which has inevitably arisen from this financial and monetary management pertains to the ultimate recovery of the loan to England, known generally as the sterling balances of India in London, aggregating to more than £ 1,000 m. by now As pointed out above, this loan to England was not offered in the main by those who made or owned large incomes during the war but was extracted in the main from those of the middle and lower classes who had the misfortune to live on relatively fixed incomes. When England sends goods, preferably capital goods, in payment of these balances, the place of the sterling securities now held by the Reserve Bank of India could be filled by rupee securities now in the hands of the Indian public, thus leaving the monetary circulation of the country unchanged. In technical language, the Reserve Bank will be carrying out open market operations by purchasing securities against the rupee finance offered by the importers. In this manner, a relatively very wealthy country like England would enable a relatively poor country like India to maintain her level of money incomes and savings even while receiving an excess of imports. The unfortunate classes adverted to above whose original sacrifices created the sterling balances will receive their compensation only indirectly in the shape of a share in the expanding prosperity of the country.

The implications of such repatriation for England must also be duly considered. Like all debtors, England has already raised the question of her capacity to pay and is asking for time, moratorium, easy instalments, etc. with much grumbling about the hard circumstances which forced her to borrow and accept

adverse terms. Having waged all the wars of her long history for just causes and philanthropic purposes, this is but to be expected.* England's capacity to pay must obviously depend on her net national income, the fraction of the income she is prepared to save, and the fraction she can be pursuaded to surrender to her creditors. According to official figures, the national income of England, was £4,604 m. in 1938 and £8,172 m. in 1943. Of this income, she saved £158 m. or 3·3 per cent in 1938 and £1,407 m. or 18·3 per cent in 1943. Taking the median of the two years, it would be a moderate estimate to place her post-war income at £6,388 m. and her savings at about £750 m. annually. A 9 to 10 per cent rate of savings is much less than what many advanced countries like Germany, Japan and Russia willingly bore in pre-war years and if England retained as much as £450 m. for augmentation of her capital equipment and parted with only £300 m. per annum,† the whole of her foreign liability will be extinguished in less than 10 years. England's annual liability and the period over which it will be spread are ridiculously light compared with the terms she and her Allies have sought to extract in the past from much poorer vanquished countries.

While the capacity of the United Kingdom to liquidate the balances in a short space of time cannot be doubted, her insistence on settling these balances bilaterally instead of multilaterally raises some difficulties. The desire for bilateral agreement may be inspired by two different motives. It is possible that England desires to make each release of these balances dependent on a corresponding purchase of British goods. Such a procedure offers the advantage that it raises no transfer problem and might mean favourable prices for England. If, on the other hand, the payment has to be made by an excess of exports spread over the whole world such excess could be achieved only by an improvement in productive efficiency relatively to the rest of the world or alternatively, by a reduction of wages and incomes, a direct and conspicuous lowering of the standard of life. In the former case, the level of monetary incomes and wages continues undisturbed while in the latter case the level

* See *Blocked Sterling Balances*, by P. Einzig. *Banker*, Dec., 1944.

† New capital issues in the boom year 1929 equalled £376·1 m.

must be maintained lower relatively to the rest of the world. A bilateral agreement with conditions about the country of purchase is, however, a negation of the whole trend of post-war reconstruction—the promotion of multilateral trade. It is therefore not unlikely that the desire for bilateral agreement relates not to the actual form or method of payment but to the fixation of the amount to be paid each year and its allocation to the different creditors.

The Future of Our Monetary System

Our discussion of the financial and monetary issues of the War leads us inevitably to a consideration of the future of our monetary system in post-war years. The Bretton Woods Conference has raised this question in the form of a vote for or against membership of the proposed monetary fund. Actually, our choice has to be made from a much wider and general standpoint, namely, the futute of the Indian economy itself.

Wealth Significance of a Monetary Agreement

The Bretton Woods plan starts with the postulate that an enlarging of foreign trade with its implied territorial specialization is one *sine qua non* of enlarging of income and employment in post-war years. The experts' statement preceding the plan spoke of its objective as 'expansion and balanced growth of international trade' and 'and a high level of employment and real income *therefrom*' (Italics ours). The monetary steps which were to lead to this expansion of foreign trade were conceived of as 'correction of maladjustment in balance of payments', 'exchange stability', 'shortening of periods of disequilibrium', 'multilateral payment facilities and avoidance of exchange restrictions' and so on. While it would be questionable logic to accuse the Bretton Woods approach to high level of employment and real income of reversing cause and effect, there is an implicit danger in this approach of mistaking the proverbial tail of the dog for the dog itself. Recent experience in several important countries and particularly in the United States has amply demonstrated that fluctuations in domestic employment and output which have little or no connexion with foreign trade as such are far more disastrous to its volume than tariffs,

exchange instability and other obstacles to free interchange of goods between country and country. This is specially true of large and rapidly advancing economies among which India hopes to find a place in the post-war years. When domestic employment and output are assured of unimpeded progress, tariffs, stable exchanges, etc. at once fall in their proper places as conveniences and facilities rather than essential conditions of international trade.

Monetary Postulates of a Planned Economy

If India adopts a planned economy as the only means of rapid increase in our national income, the question of our foreign trade and foreign exchanges must present itself in an altogether different light. A planned economy has little significance except in the context of a planned investment. Such planning of investment is likely in the case of this country to be directed to three objects—the substitution of productive investment in the place of present unproductive investment as in the case of gold and silver; investment in the general pre-requisites of productive efficiency like education, health, science, etc., and finally, investment to assure output in conformity with some agreed scheme of social and economic priorities. It is clear that mere increase in productive investment, e.g., by prohibition of imports of precious metals or their rationing and price control, etc. need have no superseding effect on the ordinary inter-country competitive structures of costs and incomes. The second kind of investment raises only one question, namely, that of distinguishing between fruitful and wasteful expenditure and has no special significance for the competitive mechanism of foreign trade as such. As a matter of fact, investment of these two kinds is no special mark of a planned economy.

It is investment of the third type which raises subtle questions of economic policy and adjustment and is the distinguishing mark of planning and planned economy. Such investment may take two forms. One kind of investment might aim at rectifying or improving the existing combinations of factors of production and by a more liberal employment of those factors which are fairly elastic in supply may conceivably raise the output. A larger use of manure per acre or a larger employment of machinery per textile labourer might for example give us

more than proportionate increase in food or cloth. Yet, beyond a certain point, such application of resources must cease to give equivalent output and the second kind of investment, which consists of increased employment of all factors in the particular desired lines of production, has to come into operation. Such an all round investment of resources cannot but raise far-reaching reactions throughout the economic system. If food, clothing, houses, basic industries and transport represent our scale of social priorities, this investment will mean a fall in the values or incomes of certain factors like commercial crop lands which must lose their present more profitable employment and a sharp rise in the values of other factors like cement, timber, iron and steel, bricklayers, engineers, technicians, mechanics, etc. which will be now more in demand. While we are effecting in this manner an authoritarian transfer of wealth and income from certain classes to certain other classes, less cotton, less oilseeds, less jute and perhaps less hill produce might cripple our capacity to export and therefore to buy from abroad, while at the same time the enhanced values of other products might attract their imports from outside. In the matter of imports, much will depend on the actual character of the investment whether it involves relatively more use of resources like land under commercial crops, building sites, bricks, most kinds of timber, labour, etc., which in any case must all be found within this country or other resources like machinery, tools, rare skill, etc., the local supplies of which must meet with strong competition from abroad. A much more difficult question to decide is how the expansion of certain lines of production and shrinkage of others will affect the expenses of production in either, for exports and imports cannot be considered apart from domestic costs and income levels. Expansion of housing and transport facilities might attract proportionately so much unskilled labour that costs would be raised in the output of food, non-food and textile commodities no less than goods which are outside the range of our agreed social priorities, like luxury and handicraft goods, etc. The growth of basic industries without which a planned economy will be a criminal waste is sure to raise labour and material costs in whatever engineering, constructional and machine industries exist at present. Whether the

expanding industries will show a fall of costs per unit is much more conjectural. While expansion by itself does not appear likely to cause any radical changes in the organization of agriculture and therefore any fall in the costs of food output, economies of large scale etc. in housing, textile, transport and basic industries and particularly in the industries which are ancillary to them might in the long run bring about a fall in the costs. Ultimately, all these reactions and counter-reactions have to be traced to the hard fact that no planning can escape the difficulty that some of the primary real factors of production like land, technical skill, etc. cannot be susceptible to quick increase.

Our tentative and general analysis of investment on the basis of social priorities instead of domestic and international demand has served to make it clear that it involves a very selective control of imports such as are likely to be attracted on account of changed values but are incompatible with the basic objective of planning and, in case of a prejudicial rise of costs, some special encouragement or subsidization of exports such as are unavoidable to secure our requirements from abroad. In case of such controls on foreign trade and exchanges, the Bretton Woods plan which is based on the principle of non-interference with the 'domestic, social, or political policies' of countries but which expects members 'not to impose restrictions on payments for current international transactions with other member countries or to engage in any discriminatory currency arrangements or multiple currency practices' has a relevance only as a possible source of short-term loans, pending authoritarian adjustments of imports and exports.

It is quite possible that in actual practice, the logic of a planned economy may not be adopted to its full extent. Our planners who have met their difficulties by evading them are more likely to console themselves with some control of imports, some licensing of factories and capital issues and, on the positive side, some generally accepted reforms of agriculture and industry likely to stimulate their efficiency. Their social priorities are most likely to wait on some cautious redistribution of incomes stage by stage.

Bretton Woods Plan under Competitive Economy

Apart from the adoption of a planned economy, it may be

useful to consider the Bretton Woods plan on its own basic assumptions and merits. What are the positive advantages which membership of this fund is likely to confer on this country? Under the gold standard and the national exchange equalization funds which succeeded it, an adverse balance of trade meant either immediate or proximate monetary action to reverse the current of trade or loss of accumulated reserves or acquisition of loans abroad to obtain a breathing space. The proposed fund makes it possible for all members to be sure of such loans or credit, limited, however, to certain maximum at a time and a certain period of years. It is clear that this facility is of importance to such countries only as suffer from periodic adverse balances and do not command in case of need of sufficient credit in the international money markets. India now or in post-war years is hardly likely to fall into this category. Secondly, it used to be a great advantage of the orthodox gold standard that in case of adverse trade balances, the inconveniences or hardships of monetary readjustments were shared to a greater or smaller degree in accordance with the size and resources of the countries between the surplus and deficit countries just as it was a disastrous mistake of the managed gold standard and other monetary devices that surplus countries sought by their means to throw the whole of this burden on the unfortunate deficit countries. Under the Bretton Woods plan, the deficit countries are offered only the respite spoken of above and there is no assurance that surplus countries will be prevailed on to take monetary action calculated to moderate the severity of the parallel action by which deficit countries are expected to achieve readjustments of costs and incomes. Not to have this assurance and yet to be restricted in the liberty to adjust the exchange rate would certainly be not a privilege but a hardship of the fund membership. The point which has attracted most attention however relates to the condition which makes loans and financial assistance from the proposed international bank dependent on membership of the monetary fund presumably on the ground that such membership is a guarantee of that monetary and exchange stability which ensures a due repayment of the loan raised. Whether non-membership will entail on this score any hardship for this

country will depend on whether we want such loans, whether there are any alternative sources for such borrowing, and finally, the explicit and implicit conditions attached to such loans. The Bombay Plan for example postulates foreign borrowing to the extent of Rs. 700 crores, which means in the absence of such assistance a curtailment of annual consumption of Rs 45 to 50 crores. As for the alternative sources, the fund or the bank does not contemplate any prohibition of non-members raising loans privately in member countries and certainly can exercise no veto in countries which choose to remain outside. It is difficult however to forecast now the countries which will remain outside the orbit of the fund. As for the conditions, we cannot overlook the fact that the fund will really be a club of countries which belong to a political and military alliance and which in the past have exercised economic pressure ruthlessly to attain political and military ends. If instalments of agreed loans were suddenly terminated under political motives, the economy reared on these expectations must receive a staggering jolt. An international loan has, however, this advantage over a national loan—that it creates no bias in favour of any particular market dependence on which has in the past served as a powerful lever to extract political or military concessions. These economic issues will be further overshadowed by our ethical or strategic attitudes towards European and Pacific power politics and wars.

The long-run advantages of the Bretton Woods plan analysed above are neither definite nor such as are unobtainable by other means. But India like many other countries is also confronted with more proximate post-war problems in money and foreign exchanges and in a world in which the future cannot be seen beyond a few years, provision for life from day to day is certainly the best and most unescapable wisdom. One of our imminent post-war problems is not the acquisition of financial favours from the great economic powers but the return of what the United Kingdom and, therefore, indirectly the United States have received from this country, namely, the sterling balances. The fund specifically excludes the settlement of these 'abnormal' balances from its purview in favour of bilateral agreements. Since the basic assumption of the fund is multilateral trade, it is logical to presume that the agreements are expected to

cover only the instalments and the period of repatriation and not the form, with its accompaniment of hidden political pressure. In any case the fund offers us no facility on this urgent issue. The second imminent problem of post-war years is an exchange parity which will enable us to maintain our export trade at a level high enough to cover our import needs. The crucial question which arises in this connexion is whether membership of the fund will enable the Government of India to settle a gold parity directly with the fund and how such freedom is to be reconciled with the assurance given to the British Parliament of the unbroken continuation of the sterling block. Finally, the fund specifically excludes from its responsibility the one outstanding cause of currency instability during the peace interval, namely, large, sustained or sudden outflows of capital and thus places on each country the burden of creating and maintaining adequate exchange reserves for the purpose. The only form in which such outflows are likely to occur from this country is non-monetary reserves of precious metals and it would be desirable to know whether embargo on such exports falls within the meaning of restrictions not to be practised by member countries. If such embargo falls within the prohibitions of the fund, it must be counted as a disadvantage of the fund membership.

If India decides to remain outside this monetary-cum-political-cum-military alliance, it would be necessary to consider the hardships or inconveniences of such a position. Since the fund is ostensibly a voluntary association and England and the United States are least likely to desire a loss of their markets in India, no economic retaliation as distinguished from back door pressure need be feared. If the rupee must seek some anchorage from time to time, we should then be free to choose a currency, whether a member of the fund or not, which promises the greatest stability and the freest exchange market. As the disturbances of the War have demonstrated, the preponderance of naval and air power is no mean consideration in the choice. As for inconveniences of instability in relation to other world currencies, an efficient forward market in exchanges is proved by experiance to be the most permanent safe-guard.

CHAPTER VIII

INVESTMENT AND INTEREST RATES DURING WAR AND PEACE

The immediate and distant future of interest rates and investment is a matter of critical importance to individuals and financial institutions. Banks, insurance companies, investment trusts, etc. have in particular a large and vital stake in investments which appreciate or depreciate in accordance with the trends of interest rates. Apart from individual or sectional interests, the whole economic system, the levels of investment incomes and employment are dependent in a significant measure on the way these rates will behave in the near and distant future. True, economic thought is today not as optimistic about the aggregate and definitive influence of interest levels as it used to be a few years ago. Investment and profit prospects, or to put it more realistically, expectations about investment and profits are now felt to depend on some other factors besides these rates.

The regulating function of interest rates has been much obscured by the role assigned of necessity to money and finance during the present War. Many persons are now inclined to think and speak as if the rate of interest is not the price of capital subject to the inescapable forces of demand and supply, but merely a minimum reward to inducement to save, to be fixed arbitrarily by the public authority according to its own estimate of what the public will tolerate. Arguing on this basis, they take it for granted that the present rates can continue indefinitely and build up their post-war plans and policies accordingly. The more or less complete prohibitions of private investment, the curtailment and rationing of the supply of several prime articles of consumption, the continuous issue of lawful money, etc. are either overlooked or forgotten. The situation is, however, bound to change materially when these controls and arbitrary interferences are progressively abandoned and the normal force of consumers' choice and freedom of business enterprise are permitted to have freer play.

Post-War Demand

Whether we agree or disagree with the thesis of Colin Clark that economic progress consists of a regular succession of capital-glutted and capital-hungry periods of about twenty to thirty years and that we are now in the midst of a more or less prolonged capital-hungry period, there can be no doubt that for many years after the war, there will be an intensified demand for capital from all sides. In the case of this country, three important sources of this demand deserve to be specially stressed. For years now, the capital equipment of existing business units has been exploited most intensively without any appreciable replacements. Not much new capital has been allowed to come into existence either, whether to meet the requirements of normal growth or to utilize the unusual opportunities of war or post-war years. In the second place, a special place must be accorded in our estimates to post-war housing and house-building on the ground of the magnitude and special character of the economic and social interests involved. While the present overcrowding of cities and towns may prove to an extent a temporary phase, the tendency to future industrialization and the complete suspension of residential construction during the last few years are bound to maintain an unwonted pressure on living space for years to come. Nor must we overlook the important fact that the investment requirements and proclivities of large classes of people in this country are sure to exploit to the full the marked disparities in returns which must reveal themselves between this form of investment and other gilt-edged investments. Finally, we must take into account the formidable requirements of the governments in this country. The Indian Government like all other governments has piled up a large volume of short-term and medium-term indebtedness, the funding renewal or repayment of which will be a long and difficult process. If we add to indebtedness the demands of post-war schemes of repairs, reconstruction or development fathered by the Government or public leaders, the pressure of public borrowing by itself is not likely to be easily appeased for many years to come.

Post-War Supply

In the next chapter we estimate the annual pre-war

visible savings of this country (and incidentally, their allocation) at about Rs. 100 crores. Taking visible and invisible savings together, the total is unlikely to exceed Rs. 300 crores. If the present levels of prices and incomes are allowed for, the surplus out of which all our post-war ambitions are to be satisfied must fall appreciably short of Rs. 1,000 crores. Restrictions, economies of public and private expenditure, etc. might, however, enable us to raise the disposable surplus to that level.

Leaving aside the investible part of our sterling balances which are unlikely to flow back in an annual instalment of more than £100 m. or Rs. 130 crores, some relief might be sought in foreign loans. This is, however, a very slender possibility. The one country which could and in its own no less than world interests, should offer its capital surplus to others is the U. S. A. A global scarcity of dollars is one of the few certainties of post-war economics. It is still very doubtful whether the wisdom of the United States will rise equal to the logic of monetary and economic facts and necessities. And in the case of India, we have perforce to take into calculation the unavoidable difficulties of her doubtful and unenviable international status.

Control of Investment

The industrial demand for capital will be intensified according as the present restrictions on profits are relaxed quickly or slowly. The existence of an excess profits duty is fully justified by the conditions of war. But in times of peace such duties tend in the long run to stabilize business at artificial levels of efficiency and harm economic progress. In the case of existing production units, such a duty based on certain standard profits has a tendency to restrict the expansion of each unit relatively to all others In the case of new enterprises, either of two things must happen. By restricting the expansion of existing units, the duty gives an artificial encouragement to the creation of new units which may not justify themselves in the long run by their in rinsic merits. Or, when the new units are more efficient than the old, the dead levels of maximum profits prevents them from expanding beyond a certain point and impinging on the field of old but

less efficient units. Finally, with a dead level of maximum profits in all lines of production, the duty must place a premium on existing lines and methods of production to the ultimate detriment of all-round economic betterment. These reflections suggest that the present excess profits duty will have to give way by stages to more steeply graded income and super taxes which are more compatible with conditions of peace.

While all this pressure on post-war capital market is conceded it is still possible to argue that a rise in interest rates cannot eventuate itself unless the pressure passes beyond the limist set by our national savings. So long as these demands on the market do not exceed available savings, interest rates can continue at the minimum levels at which the public is willing to save rather than consume. Such an argument clearly postulates the adequacy and suitability of some public authority to arbitrate between capital demands of various kinds. With War as the sole objective of national effort, a government has an index of priorities according to which it can restrict certain capital imports, prohibit certain kinds of factories and generally regulate capital issues. But when peace restores consumers' choice, it is difficult to make out how a government can exercise the regulating function of interest rates and profits correctly and efficiently.

Restrictions on public issues of capital will merely stimulate enterprise other than joint stock. Prohibitions on certain kinds of factories will tend to confer special advantages on business units which already exist and encourage the growth of crude and inefficient cottage and domestic production at the expense of factory and power production. An economic structure raised on such artificial foundations can be kept in existence and sustained by such artificial means alone and must fall the moment it is exposed to the operation of natural forces.

These considerations do not and need not preclude some restrictions and prohibitions of a broad and general character on the creation of concerns of an unnecessary character. Apart from such minimum interference with investment activities, it would be more to the purpose if drastic powers were invoked to mitigate or prevent some of the rank abuses of joint-stock

enterprise and the investment market. This is a large, but extremely urgent subject which cannot be discussed here adequately. But two things must be recorded here as of immediate necessity. The Government should determine and announce here and now a list of public utility and other services which it will as a rule undertake in the future and which will therefore be removed outside the range of private control and management.* Secondly, the whole field of company law should be subjected to a drastic and immediate overhaul with the object of eliminating monopoly or minority control of shares and stocks, financial manipulations by office bearers, perversion and abuse of audit and accounts, the enormous losses of still-born promotion and fraudulent management and in general of bringing the whole field of public enterprise into conformity with our ideas of post-war economic ethics.

In assessing the post-war levels of interest rates, we must not omit to note the relative returns on investments of different kinds, now and in the near future. In spite of highly inflated values and unprecedented levels of taxation, the returns of most industrial scrips of status have rarely fallen below 5 to 6 per cent. In many individual cases, the returns are surprisingly higher. Although the return of peace must compel a revaluation of investments in all lines, it is unlikely that profits will deteriorate on any comparable scale. For a few years, profit percentages

*Since these words were written six months ago, the Government of India has announced:

(i) Iron & steel, cotton & woolen textiles, cement, sugar, electric power and coal will be henceforward Central subjects for purposes of legislation etc.

(ii) Ordnance factories, public utility undertakings & railways will continue to be state owned & state operated, as also the bulk generation of electric power as far as possible.

(iii) Basic industries such as aircraft, automobiles and tractors, chemicals, iron & steel, prime movers, machine tools & electrical machinery industries may be nationalized in case of inadequacy of private capital & urgency of national interests.

(iv) Salt in which tax elements predominate may be nationalized.

(v) Coal will be considered separately.

(vi) Industries of national importance such as ship-building, locomotives & boilers may be run by the state as well as private capitalists.

might even move on higher levels, particularly if present taxation is revised. The return on housing must similarly continue on a very attractive level. In contrast with these returns, the short-term rates are today on the lowest plane ever reached. Making the utmost allowance for elements of risks, liquidity, etc., the present gap between long-term and short-term rates is too wide to continue without readjustment. Such readjustment can only mean a higher trend in all sections of the capital market.

Some Counter-Arguments

A critic academically inclined might be tempted to seek comfort in the thought that since every level of investment tends to create its own level of income and savings, the growing excess of investment over savings does not matter. Perhaps, a little reflection on the manner in which investment performs the alleged miracle of *post facto* equality of investment, incomes and savings might furnish the clue to what must happen in the circumstances under review. When investment outstrips savings the excess must cause a growing diversion of factors from consumption and non-durable goods generally, creating a growing shortage in their supply. Taking all industries together, consumption goods no less than investment goods, an acute demand for working capital of all kinds must reveal itself. The short-term rates will tend to be first forced up—dragging in their wake the long-term rates in due course.

In India, war production has taken the shape very largely of an intense concentration of resources on consumption goods and non-durable goods generally. Capital equipment, even that suitable for war production, has not received appreciable augmentation comparable with the peace or war industrial needs of the country. When the war ends, the present scale of government expenditure will fall, releasing both money and real resources for investment and production for private use. All in all, the demand for working capital will reach an intensity unprecedented in the economic history of this country.

We cannot overlook also the large volume of savings which the war leaves behind in the form of hoarded currency and bank balances. The goods and real wealth represented by these

have disappeared long ago in the smoke and destruction of the War. While these savings leave their hiding places, they will increase the supply of capital in the monetary sense, but at the same time aggravate immensely the pressure on real factors of production.

Many people find encouragement for their belief in post-war low rates of interest in the avowed monetary policy of England for post-war years. This view overlooks the fundamental difference, firstly, between the economic situation of the two countries and secondly, the ways in which the war economy has been managed, not to say manipulated, by the two governments.

In England, the pre-war problem consisted not of a shortage of savings and capital, but an alleged deficit of investment and opportunities within the country. Although the war is bound to make inroads on her saving capacity, England still continues to envisage her post-war situation in the pre-war context. Rightly or wrongly, the men at the head of thought and affairs there take the view that investment abroad does not conduce to increased production and employment at home and that control of exports of capital and purposively directed and stimulated investment at home are the necessary part of a policy of full employment. It is clear that this logic has no applicability to India whose fundamental problem is shortage of capital relatively to her immediate and prospective needs.

Besides, in the United Kingdom, the consumption of the public has been reduced to the lowest minimum and the resources thus saved have been applied to the creation of capital goods no less than destruction goods required for War. Although shortages of capital goods will be felt at the end of the war in this line or that, England will find herself on the whole in possession of quite a large equipment which can be turned over with greater or smaller adaptation to the purposes of peace—particularly for export purposes. In India, on the other hand, the concentration has been entirely on consumption and destruction goods such as could be extracted from existing capital equipment. The production of durable goods or their importation has been more or less discouraged directly or indirectly. India will thus find herself at the end of the war with sadly depleted capital equipment.

If the foregoing analysis is well-founded, it should also furnish the clue to the relevant long-term monetary policy for post-war years. Assuming that a proper parity is selected for the rupee, the danger of a further inflation super-imposing itself on the inflation of war years arises from more than one quarter —the unleashing of the pent-up forces of investment, the release of hoarded currency and bank balances, the super-normal level of cash reserves and sub-normal level of loans and advances of banks, foreign loans if available, etc. As the community accustoms itself to long and stable views of the future, a larger growth of fixed deposits relatively to the growth of current deposits might also add to the incentive of banks to search for the more lucrative assets of loans and advances. In an all-round sanguine environment like this a cheap money policy by the Reserve Bank can only aggravate the upward trend and make the ultimate crisis and collapse more certain. The skill and prudence of the Central Bank will be seen best in exercising a proper restraint on the tempo of growth and yet avoiding the other dangerous extreme of forcing the whole economic system into reverse gear. A difficult achievement of this kind means conformity to economic facts and forces not by the use of a particular weapon in the armoury of the Central Bank, but a dexterous and continuously adapted combination of all resources—discount rate, open market operations, rationing, moral persuation, joint and agreed action by commercial banks, etc.

BANK DEPOSITS DURING THE WAR

	Scheduled Banks		Total	Non-Scheduled Banks Total Deposits †	Cash in Hand & at Reserve Bank Percentage of Deposits		Investments Percentage of Deposits		Loans & Advances Percentage of Deposits		Ratio of Cheque Clearings to Demand Deposits	Branches		
	Demand Deposits	Time Deposits			Schdld.	Non-Schdld.†	Schdld.	Non-Schdld. †*	Schdld. †	Non-Schdld.			Scheduled Banks	Non-Scheduled Banks
1939–40	139	106	245	—	9·9	—	—	—	53·3	—	16·7	1938	1128	—
1940– 1	163	104	268	—	16·6	—	—	—	46·8	—	13·0	1939	—	—
1941– 2	211	107	318	20	14·5	20·7	45·4	28·9	39·2	72·7	12·8	1940	—	—
1942– 3	306	104	410	29	16·7	28·0	53·7	28·7	23·8	60·5	9·1	1941	1454	717
1943– 4	456	142	599	40	14·0	·32·4	51·4	24·9	26·9	55·8	9·5	1942	1550	898
1944– 5	620	210	830	—	—	—	—	—	—	—	—	1943	1882	1161

† Calender years   * Excluding Imperial Bank

CHAPTER IX

BANKING DURING WAR AND PEACE

The war has proved a stimulus to banking in ways which could hardly be anticipated. When military developments removed machinery and capital equipment beyond the reach of India, enterprise largely financial in outlook and motive began to look about for other avenues which were not barred by such prerequisites. It was not difficult to discover that banking requires as little capital equipment as insurance companies and very much less than farms, dairies or rubber and tea plantations. Its chief working instrument, viz. short-term funds, the War itself was supplying in unprecedented abundance. But for tardy checks on capital issues of all kinds, the business of banking promised fair to assume the proportions of a raging epidemic.

Structure of Banking

The scheduled banks have maintained their pre-war rate of growth and regional expansion. Fifty in 1936, the number was 61 in the first year of War—1939, and 71 in 1943. Starting with 828 branches in 1936, they added 449 by 1939 and an additional 445 by 1943. Of these 445 new branches of war years, the Imperial Bank and the Big Five were responsible for 150. As one should expect from the operation of the Indian Company Law, 1936, the number of non-scheduled banks has fallen steadily from 626 in 1938 to about 557 in 1943. In other words, about two-thirds of the branches of war years and the bulk of regional expansion are to be ascribed to the smaller scheduled banks which hold less than 20 per cent of the deposits of Indian joint-stock and 8 per cent of the deposits of the Indian banking system. In spite of the enormous inflation of deposits, the volume of resources per branch rarely exceeds in their case Rs. 15 lakhs and in most cases lies in the neighbourhood of Rs. 3 lakhs only.

Nevertheless, this rather exhilarating expansion in banking business is on the whole free from any perceptible weakening of the banking structure as a whole. The war has, if anything,

intensified the pre-war trend to a higher degree of concentration. The relative position of the Imperial Bank, exchange banks and Indian joint-stock banks remained indeed more or less unaffected till the end of 1941. The entry of Japan in the War proved the real adverse factor for exchange banks whose proportion of aggregate deposit resources of the country declined for the first time in a marked manner from a little under 29·5 per cent before the war to about 25 per cent in 1942 and less than 20 by 1943. The Imperial Bank with its new venture into the field of exchange business and its high prestige and favour with big clientele reaped the bulk of the advantage from the loss of ground suffered by exchange banks, improving its share to about 37 per cent in 1942 but receding to less than 30 per cent by 1943. The relative position of Indian joint-stock banks made a stride in 1943, rising to 46 per cent of the total deposits of the Indian banking system.

Among the Indian joint-stock banks themselves, the process of concentration made noticeable progress till 1942, but the rise of new banks suddenly reversed the trend in 1943. Of the 46 per cent of aggregate deposits held by Indian joint-stock banks, the Big Five increased their share from less than 70 per cent in 1939 to more then 80 per cent in 1942, but lost heavily in 1943 to less than 60 per cent; and the Big Seven from more than 75 per cent to more than 61 per cent.

War Structure of Liabilities

From the standpoint of practical banking and banking policy in general, a striking feature of the years of War is no doubt the change which has taken place in the character of the working resources of banks. About the onset of the War, fixed deposits accounted for about half of the deposit liabilities of banks. During the War, fixed deposits have hardly increased, while current deposits have mounted very fast. By 1943, fixed deposits amounted to no more than about a quarter of the total. It is true that this change is the continuation of a process which was initiated during the last War and reinforced by certain other powerful causes in post-war years. But the extent of the present change within the short space of time during which it has materialized is so striking that mere continuation

of an existing trend is no more than a small part of the explanation.

We must first inquire into the public preference for different forms of investment and the position of banking funds relatively to other funds. The decade 1921–30 may be taken as representing stable conditions. While monetary changes were not altogether absent, the stability in the volume of deposits eliminated one complicating factor. Besides, India continued to play in these years her normal role as an importer of precious metals. Assuming that the relatively high prices at the outset of the period were more or less balanced by the relatively low prices at the end, the total volume of visible savings for this period appears to be in the neighbourhood of Rs. 900 crores. These visible savings were distributed roughly as follows:

	Rs. in Crores 1921–30	1939–43
Growth in bank deposits	nil	364
Growth in Post Office savings and cash certificates	50	—15
Growth in Working capital of co-operative societies	55	30
Growth in Paid-up capital and reserves of joint-stock companies ...	120	50
Growth in Public Debt (minus increment in bank holdings)	180	350
Growth in Premium income of insurance companies	70	15
Growth in Precious metals	350	—
Total	825	794
Annual Increment Rate	82	200

While the present level of prices and incomes has multiplied the volume of monetary savings several-fold, War has distorted out of shape the familiar pattern of investment. Post Office savings and cash certificates have fallen by several crores. The paid-up capital of joint-stock companies has hardly changed although their reserves have mounted considerably. The progress of co-operative credit societies had almost ceased before

the War. As against the disappearance of the normal outlets of investment, the growth of bank deposits records an increase of about Rs. 400 crores, and public debt, of about Rs.500 crores. A large volume of our savings running annually at the present level of prices and incomes into about 200 to 300 crores which in ordinary times found visible investment is lurking somewhere in our economic system. If to the normal volume of visible savings, we add other forms of savings of which there is no record, this lurking capital will reach a still higher figure. Leaving aside normal investment in enterprises other than joint-stock, the pre-war investment in housing could not be other than very massive, perhaps as large as our visible savings. House-building was in its boom phase during the few years before the War and has been altogether at a standstill during the War.

There is little doubt that these floating savings have sought conversion into such durable assets as are available. Precious metals, however, were not allowed to be imported, except lately. Stocks of land and houses have remained more or less stable. Scrips of public companies have not received appreciable augmentation. Thus the search for safety has merely raised the prices of these assets and shifted the onus of applying the new savings from those who purchased to those who sold. It is probable that a large part of these sale proceeds exists in the form of mere idle hoards of currency notes but the much larger part has, it is to be feared, found its way ultimately into the hands of those whom the distress, famine and privations of War have compelled to consume their past savings. In other words, disinvestment or dissipation of capital on a scale never seen before in this country is now taking place before our eyes.

Overshadowing by far this private disinvestment of capital is the colossal process set in motion by the finance of War —of converting ordinary, genuine savings into consumption and destruction goods. The Government tried to seize public savings in the first instance by taxation and borrowing on an unprecedented scale and when these proved inadequate to meet the growing bill of Indian and Allied war expenditure, by the easy device of inflation against sterling securities.

A war economy has to cope with shortages in many requirements not all of which have any comparable significance for life in peace time. Ship-building, machinery of various kinds, chemicals of all kinds are examples of industries which have as much significance for peace as war. Prudence should have made it obvious that India should concentrate on the creation of these industries rather than the exploitation of existing industries in pursuit of profits arising from War. Such a policy presents a two-fold problem. A part of the flow of economic resources into production of commodities which offer immediate profits but have little significance for the future, had to be diverted into these new industries as long-term investment. Control of capital issues, excess profits tax, etc. are the obvious means to achieve such an objective. Secondly, as private enterprise is not always prepared to launch into such new ventures, particularly during a war, it has to be considered whether the State itself should take the initiative, or depend on subsidies, administrative action and control, to secure the objectives. Unfortunately, such a long-range view does not appear to have commended itself to those who took charge of the financial helm of the country.

Instead, the concentration on ordinary consumption industries to which all expenditure was directed, while long term investment or creation and acquisition of capital goods fall more or less into complete abeyance, multiplied several-fold the demand for working capital in general. There has thus taken place a corresponding, unprecedented shift of funds from long-term to short-term employment, whether directly or *via* the Government. This is the main explanation of the relative stability of fixed deposits and the continuous and rapid growth of demand deposits. The profits of trade and industry are no longer useful as investment funds to create or extend capital equipment. They are more profitable when employed to enlarge the output from the existing scale of equipment. The operation of this influence not only in India but in other countries is clearly reflected in the changes of ownership of demand deposits reported as a remarkable development from the United States and elsewhere. In the former country, an inquiry by the Federal Reserve authorities reveals that two-thirds of demand deposits are at

present owned by business, while income deposits have fallen in relative importance. If a similar investigation into ownership were made in India the facts are not likely to be different.

Other reinforcing causes, but of minor degrees of importance may be compendiously epitomized as the tendency to seek increased liquidity. Low rates of interest generally weaken the inducement to hold fixed deposits and enhance the preference for liquid forms of wealth. Low interest rates are, however, an inheritance from the post-depression era. The non-availability of durable assets at prices which are deemed safe has enhanced the safety value of current deposits.

War Structure of Assets

The investment of their funds by banks has been dominated by two factors, the heavy fall in the demand for loans and advances, and the unappeasable demand of Government for loans from the public. Between 1939 and 1943, the loans, cash credits and bills of scheduled banks have fallen in percentage of their deposits from about 58 to 20; those of the Imperial Bank of India, from 55 to about 18; those of the Big Five, from 53 to about 30. As the War has progressed trade and industry have gradually released themselves from dependence on banks for their ordinary working capital. A large part of their earnings and profits figures now as current deposits and is used as working capital. Secondly, as the Government makes advance payments to contractors their working capital reaches them *via* the Government. To a more limited extent, the fall in the bank accommodation to trade and industry may be explained by the adverse effects of War on individual markets like cotton, jute and bullion, etc., the legal restrictions on so-called speculation, the elimination of intermediaries on account of direct purchase and acquisition by the Government and its agents, and the curtailment of exports and imports.

Since cash credits, loans and bills have fallen to half their pre-war importance in the portfolios of banks, they have no alternative but to seek earning assets in Government securities. The Big Five have raised their investment in Government securities from about 28 per cent of deposits to more than 41 per cent and their holding of treasury bills from 3 to about 9

per cent. The Imperial Bank has acted as the main support of Treasury Bills, 35 per cent of its total investment of 70 per cent being accounted for by them in 1942. But despite these high proportions, the void caused by falling business accommodation is hardly filled. The cash ratios of all these banks run at unusually high levels—about 15 per cent in the case of the scheduled banks; 15 to 25 per cent in the case of the Imperial Bank of India; 18 per cent in the case of the Big Five; and 11 per cent in the case of non-scheduled banks. In other words, their quick assets bear a much larger proportion to their deposits than ever before.

In their security portfolios, most banks have observed the prudence of accumulating as large a proportion of medium-dated obligations as possible. In the case of important individual banks, this proportion is reported to be as high as 20 to 25 per cent of their capital and deposits. It would, however, be doubtful financial foresight to believe that medium-dated securities are a complete safe-guard against the future. The test will come at the end of the War when and in proportion as present controls are relaxed or abrogated and normal investment trends are revived. It is to be regretted that no steps were taken as in the United States to compel banks to buy none but dated loans during the War. The warning is all the more applicable to certain banks which hold long-dated or undated securities in such high proportions as 30 to 35 per cent. With the prohibition or control of long-term investment and the creation of a superabundance of working capital, it is hardly surprising that the low pre-war rates of interest should have fallen even lower during the War. The yield of 3½ per cent security has moved up and down according to the psychological reactions to the varying fortunes of the War and averaged to 3·66 which is higher than during pre-war years but lower than during the earlier war years. A change must ensue after the conclusion of peace and at some stage of post-war reconstruction.

Capital and Profits

The changes in the ratios of capital and reserves and the gross and net profits of banks inevitably reflect, to the

exclusion of every other factor, the mere inflation of deposits. The capital and reserves ratios have fallen very low indeed, the Imperial Bank recording a fall from 12·8 in 1939 to 5·3 in 1943; the Big Five from 9·3 to 5·4; the scheduled banks generally from about 10·8 to 5. Perhaps, the enforced high liquidity of their war-time assets might appear to furnish some formal excuse for this adverse change in the guarantee offered to the numerous creditors. But in view of the fact that a volume of deposits of this size once created never fails appreciably afterwards, the vital issue, although postponable till the return of peace, cannot be avoided indefinitely. Indeed, the problem was growing in significance long before the outbreak of the War. The profits of banks have grown in absolute volume and some have even fallen under the E. P. T. hammer, unlike British banks. If their less profitable assets have expanded at the expense of others, most of them have compensated themselves by lowering their deposit rates fractionally. The return per unit of resources, however, has fallen steeply. For scheduled banks generally, the gross profits rate has fallen from 2·34 to about 1·5, the expense-ratio from 1·49 to about 1·00, the difference recording the fall in net profits rate. It is rather significant that in the case of important banks, the proportion of gross profits paid in salaries has fallen by 5 to 6 points and even more. The keen competition for trained and experienced personnel does not appear to have brought much relief except to lucky individuals; and bank employees like other sections of the middle classes are supporting the main burden of inflation profits.

Banking under a Planned Economy

In the banking and currency developments of the War, it is clear that the Reserve Bank and the banking system have had only a passive part. Given the financial policy and the controls of investment and consumption adopted by the Government, the Reserve Bank has merely issued currency notes against sterling assets and commercial banks have acted as the medium for holding what surplus income the public chose to hold in the form of deposits and thus to reap where they have not sown. This suggests to some the possibility that

under a planned economy of the future the role of the banking system might alter so radically that the justification of the banking system as a private enterprise might no longer hold good. For more than one important reason, such a view does not appear to be well founded. As we have observed again and again, in any kind of planned economy established in this country, large sectors of consumption and investment activity must lie outside the reach of Government control and action. In other words, the argument that savings under a planned economy involve no effort on the part of individuals and do not require any special inducements to be drawn into active economic service will not hold true of this country. Secondly, if controls and inflation augment the working resources of banks, the appropriate method of dealing with them as with other trades and industries is by taxation and excess profits duties. Finally, it must be recalled that in a country of diverse economic conditions like India, banks on different planes of policy and business alone can fulfil the function of appealing to different classes and localities and any standardization of banking organization and practice will simply bring to a halt banking progress. When we turn from the savings collecting function to the function of allocating them to business units and industries, it will be seen that their services as judges of individual prospects under an economy in which large sectors of activity will still lie with private initiative and enterprise, will continue to be no less vital and urgent than now.

Although the plea of enforced savings cannot be used in India to operate banking on a cost-plus basis, and the abolition of competitive banks will only halt the further spread of the banking habit, and the allocation of working capital cannot be entrusted to the Government without entrusting to it all trade and industry as well, it must be conceded that planning on any important scale will certainly entail profound reactions on the banking system and its working. The Government must tend whether directly or through statutary authorities, whether singly or in close co-ordination with co-operative organizations etc., to become more and more the biggest single borrower of short-term funds. The volume of its requirements will approach more and more unprecedented levels as it

undertakes to run or manage public utility concerns, commercial enterprises, public works, acquisition, storage, import and distribution of commodities, specially agricultural produce etc. A question of the utmost economic significance is whether the Government should borrow all such funds directly by means of treasury bills or whether each authority should borrow separately, submitting in the process like all ordinary borrowers to banking discipline. In any case, as the banking system grows more and more dependent on this single borrower for investment in loans and advances, which must be continuously renewed as a matter of course, the time-honoured concept of liquidity must retreat in face of a new situation in which the solvency of the banking system becomes identical with the economic efficiency and solvency of the Government itself. Nor can the structure of the banking system itself escape profound modifications. While the continued existence of private businesses of all sizes and degrees of efficiency would seem to call for numerous banks at all levels of organization, the existence of one great borrowing leviathan cannot but have the effect of stimulating amalgamation among those from whom these resources must flow.

Again, banking credit will have to be co-ordinated not only with accepted social and economic priorities but also with such restrictions and prohibitions of capital issues and factories as may be in force. Serious evasion and leakage must ensue if permanent capital is made available in the guise of temporary but renewable loans and advances, or if funds which cannot be placed at the disposal of joint-stock enterprise percolate into the hands of private and domestic concerns the objects of which run counter to priority policies. It may well happen also that banks may be expected to play a more active part in the industrialization of the country and particularly in the supply of long-term and medium-term capital than they have done in the past. Much will depend on the future of loans and advances which have now reached the extremely low level of 25 to 30 per cent and investments, largely Government securities, which stand at the level of 40 to 60 per cent. With the creation and proper functioning of the Reserve Bank, there would be nothing wrong in expecting the commercial banks to disburden themselves of Government securities and to concentrate on their proper banking

function, namely the financing of trade and industry. What proportion of banking funds thus released could safely find their way into the fixed assets of industry is another matter. Leaving out of account a probable post-war shift from demand to fixed deposits—and much depends here on the course of interest rates—a maximum of total capital and reserve plus one quarter of the average fixed deposits over the preceding five years may be suggested as a safe upper limit. But this means automatically a widening of the eligibility conditions of the Reserve Bank and a very close contact with and supervision of banks by the Central bank.

CHAPTER X

FUTURE OF FOREIGN EXCHANGES

It is not our object to make any prophecies about post-war exchanges. No one who has any experience of economic realities will venture on such a perilous course. What is proposed to be done is to consult and interpret our experiences since the end of the last war, and to extract such guidance as we can from them. It is important to stress the fact that the financial and economic course of events during the two World Wars presents material contrasts and it is hardly to be expected that history will exactly repeat itself. While individual countries have certainly learnt nothing in the moral sense from the ruin and destruction of the last War, they have definitely learnt much and progressed much in the art of waging war, particularly on the financial and economic side. The variety, rapidity and effectiveness of the controls imposed, and the dependence on savings and taxation as the chief means of financing a war may be cited as two important points to illustrate the material difference between the two situations under study.

Taking account of only proximate causes, and without aiming at theoretical accuracy or completeness, our analysis mighr well start with a bare outline of the basic conditions governing

foreign exchanges. The price of any commodity tends to range round the level at which supply and demand reach equality. The price of one currency in terms of another, or in other words, the exchange rate, is no exception to this general proposition. The exchange rate tends to hover round the level at which the supply and demand for two currencies tend to reach equilibrium. The supply of an individual currency for the purposes of international trade, is given by the volume of goods, which the country in question chooses to import. For, in the first instance at least, the country in question has to offer its domestic currency in payment of these goods. The demand for the cnrrency, on the other hand, is given by the quantity of goods or exports which other countries have purchased from it. For, these goods or exports must ultimately be paid for in the domestic currency of the country from which they have come.

While exports and imports furnish the proximate index to the supply and demand of a country's currency for the purposes of international trade, the exports and imports themselves depend on more ultimate factors. The demand for any commodity depends on the price for which it is offered. The demand for the exports of a country depends similarly on the terms on which they are offered in a competitive world market. At any particular moment of time, these terms reflect, and in turn determine, the level of costs and incomes within the country which offers the exports. Since the supply of exports constitutes also the demand for imports, it is clear that the terms of trade and the levels of costs are ultimately the outcome of the whole supply and demand position of the countries concerned. It is sufficient for our present purpose to bear in mind that the proximate forces which operate to bring about equality or inequality of exports and imports represent the costs and incomes of the participating countries relatively to each other.

Causes of Disequilibrium

The study of post-war exchanges is very largely a study of those causes which are likely to operate on the balance of exports and imports and those others which operate on the relative costs and incomes.

The first direct legacy of war is abrupt territorial changes, and the economic disruption of the life of large communities which these changes imply. The defeated countries are deprived of a large capacity to export. The loss of Alsace-Lorraine and large parts of Silesia illustrate, in the case of Germany, such loss of export capacity. If the consumption of imported goods could fall to the same degree as exports, adverse effects on the exchanges would not ensue. Such an automatic balancing, however, rarely takes place. The most frequent experience is that while the consequences of defeat fall very heavily on the mass of people who live largly on domestic production, the consumption capacity of other classes, mostly well-to-do, and normally accustomed to imported goods from abroad does fall, but in a much smaller proportion. Thus while the loss of export trade and the parallel loss of incomes falls largely on the masses, other classes like bussinessmen, traders, manufacturers, etc. seek to reach their normal pre-war consumption.

Such a type of disequilibrium is not confined to countries which have suffered defeat and loss of economic resources. Even those countries which are more or less unscathed by the direct ravages of war find themselves in a similar situation. During war, important classes of people are deprived of opportunities of expenditure and, on that account, accumulate large balances. In many cases, these balances are inflated by limitless opportunities for profits offered by war. At the end of the war, unless steps to the contrary are taken, there is the inevitable rush for consumption goods and investment goods from abroad. While imports from all parts of the globe thus flow in, the exports are not in a happy situation. The normal pre-war markets are either destroyed or are in a state of chaos. The ultimate cause of the disparity is the same as above. The classes which suffer from the loss of exports are apt to be distinct from those which are normally responsible for the demand for imports. In India, for example, the loss of exports is likely to fall in the main on the cultivators and agricultural classes generally. But the source of demand for imports is largely to be traced to traders, businessmen and the urban population in general. An inequality is therefore to be expected.

The third potent cause of severe and prolonged disequilibrium is the vast mass of one-sided payments which war leaves behind it in one form or another and of which reparations or indemnities are only a leading example. It took the distress and unemployment of several years, to lay bare to the understanding of politicians, the harmful consequences of this legacy. It is true that arrangements like Lend-and-Lease have been devised this time to meet these difficulties. But it would be too sturdy an optimism to trust the capacity of political leaders to learn from experience, or to underrate their skill for prevarication. During the last War, those who set out to make the world safe for freedom and democracy avoided the word indemnity as a reminiscence of barbarous ages. Political vocabulary was enriched with a new election slogan—reparations. With the bitter memories of post-war poverty and unemployment, the present generation of leaders is anxiously avoiding the word 'reparations'. It should hardly cause any surprise if there is a revival of the same primitive passion for vengeance fitted with the garb of something like an Atlantic Charter at the end of this War.

One-sided payment like reparations disturb the trade relations of nations in diverse ways. Difficulties start with the usual tendency to fix the payments much above the capacity of the countries concerned, whether considered over a year or a longer period of time. Since payments must ultimately take the shape of goods and services, the excess of exports which can be created, sets the limit beyond which more cannot be extracted. This excess of exports means, in the last resort, a fall in real income and wages—an all-round lowering of the standard of life, to which in a modern, civilized community there are well-recognized limits. When taxation and reduction of incomes have been carried to the point of resistance and revolt, the unfortunate debtor country has a sore temptation to fall back on rank inflation and depreciation of exchanges as the only escape out of an impossible situation. Again, the form in which the payments are made becomes a matter of deep concern to the receivers thereof. If the goods and services which the lowered standard of life enables the vanquished country to send abroad, compete directly with those of the victorious countries whether in home or foreign markets, disturbances of a serious

character arise to the economy of the victors who are presented with the not very enviable choice of becoming unemployed dole-receivers at the expense of their former enemies. At the same time, the lowered standard of life of enemy countries aggravates the evils by curtailing some of the most important markets of the world.

Another great disturbance to the balance of credits and debits which was fatally overlooked at the end of the last War is the great harm which war inflicts on the habits and scale of domestic and international investment. Wars of the present magnitude can leave nothing behind them except political instability, endemic fear of revolutions, economic insecurity, etc. In an environment of this kind people tend inevitably to keep their capital as liquid as possible, and to move it from one centre to another on the slightest suspicion of danger. When capital moves under economic influence, represented largly by differential interest rates, the balance of trade adjusts itself with ease, aided by the appropriate and parallel monetary measures. Influx and efflux of such capital are economically profitable, both to the lender and the borrower, and in the long run raise the output and incomes of the whole world. But when the world is cursed with a vast mass of liquid capital whose movements are unpredictable and represent nothing but fear, the monetary systems of both the receiving and losing countries are subjected to a strain for which they are normally unsuited.

The methods by which war is financed in different countries have their own share in creating difficulties in the sphere of post-war exchanges. Profiting from the experiences of the last War, some countries at least have exerted themselves to the utmost to meet the mammoth bill of war out of taxation and voluntary or enforced savings. But financial rectitude of this kind has its practical limits. A war of three, four, or even five years may be financed by strict adherence to financial virtue. But when sacrifices have to be extracted over longer periods, it is highly doubtful whether virtue can stand that strain. The situation is of course much worse in those countries which because of inadequate motive for the practice of financial rectitude or lack of practical means to restrict consumption and investment, have adopted the primrose path of

concealed or blatant inflation. The higher costs and prices cannot but prejudice post-war exports while war profits and higher incomes must make the way clear for an inundation of imports. Until costs and incomes are deflated to the outside world level, which, in case of very high degrees of inflation is apt to be economically undesirable or impracticable, or the exchange rate is allowed to fall to its economic level, the disequilibrium must persist.

When war has run its course of death and destruction, the return of peace introduces the problems of the choice of exchange parities more in harmony with the economic changes wrought by it. The choice of a particular parity is not a question of merely recognizing *de facto* conditions. The post-war position of a country in foreign markets, the probable course of domestic and international investment, transport costs, etc. are only some of the tangible and intangible factors which have to be taken into account. Mere political prestige, existence of external debts relatively to internal debts, etc. are other factors which incline nations to favour either higher or lower parities. With the utmost care in choice, however, the danger of overvaluation or undervaluation is always present and unless properly diagnosed and dealt with, becomes a new source of world disequilibrium. Ultimately the disequilibrium may be traceable to the failure, voluntary or involuntary, to follow the chosen parities with appropriate monetary policies. When a high parity is chosen, and is unmistakably reflected in the ensuing economic consequences, the alternatives before the offending country are either a revision of that parity or an appropriate deflation of wages and incomes. Political prestige and vested interests, many times, prevent the adoption of the first remedy, while other class interests and social policies make the latter equally inadvisable. When undervaluation is the fault, the individual country must respond by enlarging the cash and incomes in the hands of the public. This monetary logic of undervaluation is, however, so many times frustrated by the inadequacies of the technical means at the disposal of the Central bank, no less than by vested interests and political pressure. The initial depreciation of the sterling, the counter-depreciation of the dollar, the dogged deflationary policy of France, were only the logical

sequences of the over- and undervaluation of currencies which marked the post-war era.

This analysis of forces which are likely to operate on post-war trade balances serves to make it clear that it will be some time before stable conditions are reached after the close of the War. The interval will not be the same or even approximately the same for different countries. In the meanwhile, exchange controls and trade restrictions must continue and their abolition can take place only by stages and in a tentative manner. Nevertheless, a world-wide agreement on the goal towards which each country should direct its efforts is sure, in the meanwhile, to serve as a powerful force to facilitate and even expedite stable conditions. The post-war currency plans placed before us till now are an attempt to define such a common goal. A brief examination of these plans is, therefore, a natural sequel to our previous discussion.

Post-war Currency Plans—British and American

The fundamental condition to which any post-war currency plans must conform is a full recognition of the change in economic ideology which has taken place during the interlude between the two Great Wars. If international division of labour with a large foreign trade was on the whole the dominant ideal of the nineteenth century, economic autonomy is undoubtedly the dominant desire of the present century. It would be bootless labour to try to prove that this economic ideology represents very largly mere economic ignorance. Wise men can only take note of the causes which give force and persistence to this desire, and shape their plans accordingly. Certain countries, for example, take it for granted that their costs and wages structure has become so rigid, and factors of production, particularly labour, have lost their mobility to such an extent that the whole economic system has become impervious to the logic of ordinary monetary policies. Other countries are convinced that a competitive economy holds out but small prospects of economic progress, and that a controlled or planned economy alone can achieve for them a reasonable rate of progress. Still other countries feel that the non-economic factors and considerations in their national welfare do not permit them to accept maximum

economic gain as the sole object or criterion of policy. In the result, exchange depreciation, exchange controls, trade agreements and restrictions, etc. have come into vogue to control internal and international mobility of factors of production, and deprive exchange rates of their normal significance, as connecting links between domestic and foreign costs and incomes.

Indeed, some carry this logic much further and doubt whether foreign trade has any important place in the economy of the world in the future. The rapid technological progress since the last war, the amazing multiplication of substitutes and synthetic products, etc. are cited as evidence of the conquest by man of the disabilities of nature. On a sober view of the situation, however, it does not appear likely that human ingenuity and inventiveness can altogether balance the hard realities of geographical distribution of natural resources. The advantages of foreign trade must always remain solid, and in the case of certain countries constitute no mean part of their standard of life.

The currency plans outlined till now have as their objective the elimination of exchange wars between nations, and to that extent are an arbitrary disturbing element in foreign trade. The object is to be achieved by removing the regulation of foreign exchanges from the discretion of national authorities and vesting it in an international body. This body is expected to recommend the initial parities and, when economic facts justify, any subsequent changes in them. Surplus countries are to be advised by it to lower tariffs, expand credit, lend capital abroad, and in general to create conditions favourable to the growth of imports. Deficit countries will likewise be advised to adopt measures like deflation, control of foreign investment, etc. till balance in foreign payment is attained.

It is clear that the success of any such arrangement must depend on the confidence which the participating countries are prepared to repose in the impartiality of the proposed international body. If national judgement always coincided with international judgement expressed through an accepted channel or medium, the major problems which vex the world today would hardly exist. The requisite confidence would be forthcoming only if two conditions were fulfilled. In the first place, the constitu-

tion of the body should be such that it gives no cause for suspecting the preponderance of any particular country. To base representation in the executive of the Fund on the volume of foreign trade is clearly a device to obtain preponderating voting power for Great Britain. To base it on national income, gold stocks, etc. is clearly the United States' counter move against the British stratagem. Since no country in our present-day world conditions is prepared to accept any final test other than its own self-interest, it is idle to imagine that academic or technical perfection will itself assure the success of any plan. In the second place, the evidence on which the international authority takes each decision or bases its advice ought to be so unambiguous and clearly expounded that individual countries should have no cause to complain of unfair treatment. It is probably this consideration which weighed with the authors of the British plan in making the advice and action of the international authority largely automatic in accordance with the proportions which the credit or debit balances reach from time to time in each individual case. Unfortunately, automatic action of this kind is based on the presumption which may not hold true in all circumstances —that international disequilibrium ensues always from divergence of domestic and foreign costs and incomes. As a matter of practical experience, famines, collapse of individual markets, non-economic migrations and infiltrations of capital, disparity in rates of economic progress, etc., which have no direct bearing on costs and incomes as such, combine in a variety of ways to cause foreign disequilibrium and make the interpretation of each situation exceedingly difficult. From this standpoint the American plan shows deeper insight in depending less on automatic action and more on a wide margin of discretion for the international authority. It is illuminating to recall in this connexion that the World Economic Conference of 1933-4 broke up because Great Britain insisted on stabilization of exchanges when the pound was threatened with counter-depreciation, while the United States argued for a large degree of reflaction as the essential pre-requisite to stability.

Perhaps the only technical innovation which the plans seek to introduce is the manner in which the trade balances are proposed to be settled or, to put it more accurately, to be left

unsettled with token payments. Under the gold standard the claims of trading countries were adjusted by means of movements of gold. When independent paper standards took the place of the gold standard, the acquisition or loss of foreign exchange with large exchange equalization funds became the main instrument of settling these claims. As gold ministers to no human want, and is not desired by nations except as a defence or military need, it is obvious that movements of gold were only of ritual significance under the gold standard. If an international barometer were set up to reflect faithfully inter-country credits or debits, preferably expressed for convenience in an international unit like *bancor* or *unitas* and monetary action and policy were shaped by each country in accordance with the indication on the barometer, the disappearance of gold should make no difference to creditors or debtors. This is what with some differences of detail the two plans hope to achieve. The United States, which has no gold mines to boast of, is very much concerned that humanity should not in future waste its labour and resources in digging holes to bring to the surface a useless metal. In fairness to those who happen to hold gold stocks which for no fault of hers (meaning the United States herself), it is proposed, however, that gold should have just that importance which will assure for it a stable price at the present level!

Whatever the technical details and improvements which may be suggested in the course of discussions, the fundamental basis of these plans must remain the type of economy which is expected to prevail in the world of the future. The American plan is quite explicit on this issue. It postulates the abolition or moderation of tariffs, revival of internal and international freedom of enterprise, free inflows and outflows of capital, etc.—in short, a return to capitalist democracy. The British standpoint is not free from ambiguity. While subscribing to the views about the future importance of foreign trade, there appear to be large mental reservations in the British mind about domestic, monetary and economic policies. It is also more or less obvious that Great Britain is not prepared to relax, much less surrender her political and administrative control over large colonial and raw material producing areas, and the exclusive economic privilege which directly or indirectly is implied in such control. It

is also not clear how, short of dictation by the United States and Great Britain, the Russian or German type of economy can be fitted into these currency plans. In such countries, consumption is fixed by a strict system of rationing and price control, and resources thus released and others by imports are allocated to different uses on a pre-determined scale of priorities. The payments for imports are arranged by exports of goods whose competitive effectiveness is achieved by subsidies out of public funds, special taxes on industries, etc. With exports and imports strictly controlled, exchange rates are merely formal and have no link with foreign or domestic costs and incomes. The adoption of the 10,000 crores Plan or any other similar plan will mean for India a situation not materially different. Manipulated foreign exchanges, rather than free foreign exchanges, are more compatible with such types of economy.

WHOLESALE PRICES AND NOTE-ISSUES

	INDIA		UNITED KINGDOM		UNITED STATES		FRANCE		JAPAN		SWEDEN		SWITZERLAND	
	Prices Aug.1931=100	Note Issue Cr. Rs.	Prices 1930=100	Note Issue m. £	Prices 1926=100	Circulation m.$	Prices	Note Issues b. Fcs.	Prices 1900=100	Note Issues m. Yen	Prices 1935=100	Note Issues m. Kr.	Prices 1914=100	Note Issues m. Fcs.
1939	126	238	103	554	77	7598		151	278	2634	115	1248	111	2036
1940	114	257	137	616	79	8732		218	311	3636	146	1437	143	2150
1941	136	410	153	751	87	11160		270	329	4484	172	1553	184	2150
1942	171	643	159	923	99	15410		382			189		210	
1943	237	882	163	1088	103	20449		500			196	2133	218	2805
1944	245	1009		1154		23794		576				2337		3194
1945														

COST OF LIVING AND AGRICULTURAL PRICES

	INDIA		UNITED KINGDOM		UNITED STATES		CANADA		GERMANY		SWITZERLAND
	Cost of Living Bombay	Agri. Commodities.	Cost of Living	Food	Cost of living	Farm Prod.	Cost of living	Farm Prod.	Cost of living	Agri. Prod.	Cost of living
	1933-4=100	Aug. 1939=100	July 1914=100	1926=100	1935-9=100	1925=100	1935-9=100	1926=100	1913-14=100	1913=100	1914=100
1939	108	127	153	97	99	65	102	64	126	108	138
1940	114	108	184	133	100	68	106	67	130	111	151
1941	128	123	199	146	105	82	112	71	133	112	174
1942	174	165	200	158	117	106	117	83	137	115	198
1943	237	270	199	160	124	123	118	96	139	119	203
1944	247	267	200	160	126	123	119	103	143	121	207
1945											

CHAPTER XI

THE FUTURE OF INDIAN EXCHANGE

It is expected that members of the projected International Monetary Fund shall at some date after the War adopt such initial exchange parities as are agreed to by the Fund. Once a parity is established, a member is not free to change the parity by more than 10 per cent in the aggregate. Further changes imply either the previous consent of the Fund or withdrawal from it. It is clear, therefore, that the fixing of the initial parity is a matter of vital importance to all countries which elect to become members of the Fund.

In the case of India, the future of the rupee parity is sure to prove a decisive and pressing problem of the post-war era. Unpreparedness to face the situation on the termination of the conflict or delay or hesitation in implementing a previously formulated policy will imperil in a serious manner our post-war plans of reconstruction.

The question before us falls into two parts. We must make up our minds, in the first place, whether the post-war rupee is to continue its link with the sterling or to function as one of the world's independent currencies. In case the rupee is not released from its dependence on the sterling, the future of the sterling becomes automatically an important factor in determining our policy about the rupee. If, on the other hand, the rupee sets itself adrift from its historical anchorage or millstone, we shall be free to formulate our future relations with sterling and non-sterling currencies separately on the basis of the economic situation in each case.

Rupee-Sterling Parity

The question of the rupee-sterling link is not and has never been a purely monetary and economic issue. Although open avowal is always scrupulously avoided, there is little doubt that political power and interests have operated in the background and dictated the decision. It is idle to imagine that these forces will be less in evidence on the termination of the present War. We have every justification, therefore, in

placing in the forefront of our discussion the future of the rupee sterling relationship.

Preliminary estimates have to be based on price levels, costs and incomes as they exist at present. We must recognize, however, that present prices, costs and incomes are the outcome of factors some of which are exceptional and temporary in their incidence, while others may be expected to continue in operation substantially in post-war years. One of the most difficult questions before us will be to correct our preliminary estimates by such opinion as we may reach on the probable course of events in the post-war era.

In discussions and estimates of this kind, we have to use statistics as we find them. These statistics are not strictly comparable even in a formal sense. They are based on different methods of compilation, starting points, time-spans, etc. From the standpoint of economic interpretation, the loss of economic mobility between country and country and even different parts of the same country has deprived them of their usual economic signification. Even in ordinary times, when accuracy of statistics and normal working of economic forces could be postulated, the inherent limitations of the statistical technique made its application to practical problems a matter of rough approximations. Under the present circumstances, these rough approximations are useful as indicating merely the quantitative limits within which our ideas of what is feasible, expedient, or possible may be allowed to range.

According to one set of index-numbers, the wholesale price level has risen in India from 100 to 240 between the month preceding the outbreak of War and the close of 1943. According to another set, the rise has taken place roughly in the proportion of 100 to 340. Over about the same period, the United Kingdom has recorded a rise in the price level from 103 to 163. Adopting the smaller rise in India as the basis of our calculation, it will be found that the rupee-sterling parity has fallen from its pre-war level of 18d. to about 11.8d.

Wholesale prices are not perhaps an adequate index to currency parities. The wholesale price level is composed of commodities some of which have not much significance in international trade. In a country such as India, the home-trade

products easily swamp the index numbers. The use of wholesale price levels for the present purpose is justified only on the long-run assumption that prices and incomes in all sectors tend to keep pace with each other.

From this standpoint, a comparison of the prices of goods we send abroad and the prices of goods we are likely to import offer an additional basis for our guidance. According to the statistics compiled by the Economic Adviser, the prices of agricultural commodities other than food have advanced in the ratio of 100: 200. The price of our chief exports which have benefited by the exclusion of our rivals or suffered from our own exclusion in certain markets, record a much higher rise in the proportion of 100:240. On the other side, the index number for such industrial products as England now produces has changed in the proportion of 106 : 165. Taking again the lower rise in the case of India, the rupee-sterling parity would approximate to about 11.6d.

From a long-term standpoint, the interchange of products between country and country may be said to rest roughly on relative levels of costs and incomes. While wholesale prices fluctuate on account of many temporary causes and incidents, costs and incomes which measure the more permanent competitive power of trade rivals show a much greater rigidity. These costs and incomes may be trusted to adjust themselves to changes in the cost of living in a country. Leaving aside Bombay and Calcutta as rather special cases in a vast country and subject to special war conditions, and taking only semi-agricultural places like Jubbulpore, Nagpur, Madras, Cawnpore, etc., the change in the cost of living has taken place in the proportion of 100 : 260. The cost of living in the United Kingdom is reported to have changed over the same period from 158 to 199. On this basis, the parity will be found in the neighbourhood of 8½d.

As pointed out above, we have to correct these preliminary estimates in the light of probable post-war trends.

On the Indian side, the prevailing costs, incomes and prices are affected by the following special or temporary factors: (i) hoarding of goods from precautionary or speculative motives; (ii) failure of normal sources of supply, e.g. rice, wheat, etc., or

our exclusion from accustomed markets, e.g. raw cotton, raw jute, etc.; (iii) price controls and incidental restrictions imposed on several commodities and kinds of labour; (iv) hoarding of currency to evade war taxation;, (v) hoarding of bank balances and savings from liquidity motive; (vi) complete suspension of investment and concentration of Government expenditure on consumption and destruction goods. Of these causes, hoarding is losing force with the progress of time. At the end of the War, the disappearance of hoarding and restoration of our normal markets together with increase in output, are likely to exert a downward pressure on prices. But these causes are likely to be more than counterbalanced by the reversal of forces enumerated under the other heads. It will take all the skill and firmness of the Reserve Bank to hold in check the force of potential inflation which in the absence of timely measures must superimpose itself on the inflation of the war years. Allowing for the initial and immediate reactions of peace and the gradualness of the relaxation of existing controls, it would not be arbitrary to expect that the post-war years will present us with a price level with an upward trend.

The future of sterling prices is equally problematic. The international monetary discussions make it clear that England has reserved for herself the fullest monetary autonomy. This policy centres generally on the objective of full employment with cheap money as its main instrument. Such a policy is feasible in England because unlike our monetary authorities here the British authorities have managed to hold the inflationary forces of war under strict control, and capital investment for war production is in a large measure adaptable for the purposes of peace. In comparing exchange parities on the basis of the present and post-war price levels in India and England, account has to be taken of probable changes in terms of trade. If the keener demand of India for British capital goods means that more Indian produce has to be offered for British goods and therefore prices in India have to be lower relatively to British prices, there is to be set against this the compensatory fact that as the creditor of England, prices in India must tend to be higher than in England in order that the necessary export surplus from England and import surplus into India should eventuate themselves. Again if, as

seems very probable, the relatively improved productive efficiency of England should justify a price level relatively lower in England than in India, the higher transport costs of post-war years are likely to militate more against an exporter of bulky raw produce like India than an exporter of manufactured products like England and thus to depress prices in India relatively to those in England. While it is very difficult to estimate how far these contrary forces will cancel each other, questions of economic policy like tariffs, control of foreign investment, bilateral agreements, etc. must introduce further elements of a very unpredictable character.

We have then before us the prospect of a high Indian price level attempting to reach still higher levels and a relatively low sterling price level striving to reach parity with world price levels, particularly the price levels of raw material producing countries. Even if the two forces may help to neutralize each other, the present gap in the exchange parity presents a serious problem.

If for any reasons, the rupee is not able to secure its release from the established sterling anchorage, our currency policy has to take into account the future trend of the sterling vis-a-vis the other world currencies. In estimating the future of the sterling, we have to give due weight to the following imponderable factors: (i) the probable trend of British imports and the volume and competitive power of British exports; (ii) the trend of British investments abroad and external debt position; (iii) the future of tariffs, transport costs and England's internal productivity; and finally (iv) British monetary policy.

Future of Sterling

The post-war economic situation of England makes it inevitable that she should seek to control her foreign payments by (i) restriction of unnecessary imports and rationing and price control of the necessary imports, and (ii) the restriction and perhaps prohibition of capital exports. Even with these measures, considering her population and her normal standards of life, the problem of finding exports to pay for nacessary imports will be quite formidable. If the burden of any repayment of war debts is added to her ordinary requirements, the task becomes difficult but not unmanageable. While

tariffs will perhaps cause less obstruction than before, the direction of transport costs and British productivity in general is more difficult to estimate. The import of bulky raw materials and their subsequent export in fabricated form and the exploitation of mines which are centuries old point more to less favourable terms of trade than otherwise. The restoration of her old invisible items of export which gave her more than half her ordinary imports, like finance, banking and shipping services, capital invested abroad, etc. will not be as easy as at the end of the last War. The one asset of any importance which England will command in this situation is her political and administrative control of large areas of the world whose economic policies and immediate post-war requirements can be induced directly or indirectly into channels favourable to British industrial policy. If, as appears very probable, there is a very marked shift of world demand in favour of capital goods, that will be another factor favourable to Great Britain. It should be no cause for surprise if her capital equipment created for military needs is found more or less well adapted for the supply of such goods, in times of peace. Besides, such a development offers the inestimable advantage of a smooth and easy transition from public expenditure on War to private investment in industries of peace.

On a balance of all these considerations, it should not appear strange if a lower standard of life finds its expression in a further devaluation of the sterling. This means two things. The post-war economic interests of England will range themselves in opposition to any substantial lowering of the rupee-sterling ratio. Secondly, sterling will seek at the same time a revision of the existing pegged parity with the dollar. On the basis of the present rather artificial wholesale prices in England and the price level in the United States the dollar-sterling parity hardly reaches $3\frac{1}{2}$ to the sterling. On the basis of the relative costs of living, the parity is a little higher—a little more than $4 to the £. A permanent parity of about $3\frac{1}{2}$ to 4 to the £ is therefore well within the bounds of possibilities.

If the sterling is devaluated from its present approximate pegged parity of $4 to a new parity $3, the rupee will receive to that extent an automatic devaluation of 25 per cent

against most non-sterling currencies. In order to estimate the adequacy of this devaluation, it would be instructive to compare recent monetary trends in India and the United States. Wholesale prices in the United States have mounted in the proportion of 77: 103 and those in India in the proportion of 100: 240. These levels give us a parity of about Rs. 600 per $100 as against the present official parity of Rs. 332¼ per $100. On the basis of the relative costs of living of 100: 260 in India and 99:124 in the United States, the parity will be about Rs.1,108 for $100. In other words 10 to 20 per cent devaluation implied in a revised dollar-sterling parity falls far short of the existing parity of the rupee in relation to non-sterling currencies.

The question of the future relationship between the rupee and the sterling involves the balancing of many considerations. There can be little doubt, however, that the factors which weighed in the past in favour of a link with the sterling have ceased to have their old force. While the direction of our foreign trade may not alter fundamentally in the near future, the trend is definitely away from the U. K. and more towards other countries, particularly the U. S. A. Except perhaps for tea, we have hardly an export commodity for which the U. K. is an exclusive or indispensable market. It is significant that the share of the U. S. A. in our export, import and total trade has more than doubled itself during the War. The share of the British possessions and other countries around the Indian Ocean and in the neighbourhood of India has mounted by about one-third. While the return of peace is certain to restore the old channels of trade, the fact that more than 55 per cent of our trade is flowing today in these channels is not devoid of significance for the future. Our capital needs will perhaps be greater in the future than in the past. But for such capital we shall have to look in the future outside the United Kingdom, particularly to the United States. Since the plea of such a stake will no longer hold good, the Britishers can no longer claim the rupee-sterling link as an assurance of the safety and stability of their investments in India. From the standpoint of monetary management, a debtor country—particularly when that country looks forward to managed money and controlled exchanges as the main basis of its full employment policy—is hardly a centre in which

currency reserves can be accumulated, held and operated upon in safety or independence. The issues which have arisen out of our present sterling balances should be a sufficient and final warning on this subject. As a matter of fact, the considerations which prevail in deciding the form and place in which currency reserve should be held are not in present-day conditions identical with those which determine the trade interest between different countries. Experience has proved that the level of employment and national income are of far greater importance in determining the volume of trade between country and country than stable or unstable exchanges. The financial mechanism of foreign trade has proved itself quite capable of meeting unstable exchanges by means of a forward exchange market.

As stressed before, it would be unwise to place too great a reliance on mere statistical estimates. The domestic costs, incomes and prices of different countries today are the outcome of factors which represent to a material extent purely temporary or local situations. When normal trade relations are restored, these levels are bound to seek new alignments. The price levels of predominantly agricultural countries in particular must settle down on a different basis. Nevertheless, we may not expect any substantial elimination of those financial or monetary trends and facts which have come to stay as the aftermath of a great war. In a world of free exchanges and peaceful trade a devaluation from 18d. to 8d. or from Rs.333 to Rs.1,000 may not prove feasible or even necessary. Whether the devaluation of the sterling gives the rupee a relief of 10 to 20 per cent against non-sterling currencies or not, it would be prudent on the basis of existing facts and probable future trends to prepare ourselves for a devaluation of about 33 per cent, both against the sterling and non-sterling currencies. A shilling-rupee or four rupee-dollar may be set as a safe goal towards which the rupee may be allowed to move according to the force of operative circumstances.

Illusions of Higher Parity

A consideration which might be regarded as favourable to a higher rather than a lower parity is the so-called creditor position of India. It should be noted in the first place that this

change in the world economic position of India is rather overstated. There exists a distinction between an actual creditor position which adventitious circumstances sometimes create and the capacity to maintain such a position permanently. A capacity to maintain such a position must mean in the case of India the possibility in the post-war years to supply banking, insurance and shipping services, to dispense with British administrative personnel, to liquidate British investments in India, etc. It does not appear likely that India will be able or allowed to achieve these results. Our sterling balances, so long as they are intact, will give us at the maximum an income of 25 million pounds at a rate of 2½ per cent on 1,000 million pounds—an amount perhaps equal to the payments we have to make on the above mentioned heads. But a mere equivalence will mean a balanced position and not a creditor position. If for any causes, the balances are dissipated or depreciated in course of time, the so-called creditor position will be more and more reversed. To the extent and during the time that capital from abroad flows into India, the rupee will have again a stronger trend ensuing from a creditor position.

The ultimate repatriation of our balances from abroad might appear to make a higher parity more desirable. If for every rupee invested in India, we could obtain British goods equivalent to 1s. 6d. instead of 1s. only; or for every Rs. 333 similarly invested, American goods equivalent to $100 instead of $66 only were available, a higher ratio appears more profitable. But such an arrangement presupposes that we need no other imports from abroad and our exports required to pay for these inports have no competitive markets to face. In other words, without a system of exchange controls, regulated imports and subsidized exports, an advantage of this kind cannot be achieved. Under such a system, exchange parities can have no meaning or relevance.

It is sometimes argued that the rupee is in a strong position because we have abroad a large accumulation of foreign exchange and assets running into 1,000 million pounds and in so far as these are not counterparts of loans raised in this country, they could be used to support the rupee in a phase of weakness. It is also pointed out that our quota to the Inter-

national Monetary Fund is to run into 400 million dollars or about Rs. 130 crores. On the basis of this quota, India is entitled to obtain foreign exchange to the limit of a quarter of the quota in any single year and a maximum of five times that limit over a series of years. With an aggregate import trade of about 250 to 300 crores of rupees, these resources should be quite sufficient to hold the rupee at any level we might prefer. Nevertheless, it must be pointed out that we have still to decide whether and on which occasions it would be in the economic interests of this country to use these resources to support the rupee. The inflation which was the source, cause and counterpart of this accumulation is now an accomplished fact. The sacrifice or forced savings which were inflicted on large classes of people in order to build up this so-called strength are also a thing of the past not to be recalled. The economic adjustments which these monetary developments implied have to a large extent materialized and will reach their full maturity in due course. In the face of these facts, it is absurd, not to say wicked, to suggest that instead of stabilizing conditions which are a *fait accompli*, we should force this country through the trials and tribulations of a deflation simply as a reversal of the process of inflation. It is clear that the use of our accumulated resources abroad without any devaluation at home is advisable only when the foreign disequilibrium is accidental and not fundamental in the sense of arising from our costs, prices and income levels. These resources cannot be used to cure a fundamental disequilibrium without corresponding deflation.

Future of our Trade Balance

Foreign trade on the one hand and costs and income levels on the other are not two phenomena connected as cause and effect but co-existents. Costs and incomes in a country are what they are because of the presence of foreign trade and foreign trade is what it is because of particular levels of costs and incomes. Nevertheless, between the two, costs and income exhibit a greater degree of rigidity and permanence and may, therefore be represented for practical purpose as defining long-term trends of foreign trade and consequently exchange parities. Foreign trade at any particular time on the other hand is

liable to much fluctuation arising from a variety of circumstances which influence consequently the short-run course of exchanges. The termination of the war will confront every country with abnormal conditions amidst which the pressing circumstance of the hour and long-term economic trends are likely to become indistinguishable and hopelessly confounded.

A large part of our ordinary export markets was lost on account of the War. The commodities affected in this way are raw cotton, raw jute, pig iron and steel, leather, hides and skins. The recovery of raw cotton must await the recovery of Japan or expansion of our own productive power. The enormous expansion of the coal and iron industries of the belligerents makes it improbable that we shall recover much of our lost ground. Raw jute should show much recovery unless the construction of ships suited for bulk handling has progressed much.

The prospects of recovery in individual sectors of trade are conditioned by two general factors the significance of which cannot be underrated. Unlike in the last War, the ravages and destruction of this war are not confined to areas of military operations but are spread far and wide in all countries of Europe. As manufacturing countries, these are the chief consumers of our raw materials the demand for which must be postponed till their restoration to normal economic activities. On the other hand, the countries which have escaped the ravages of war are in the main the agricultural countries of the Asiatic and American continents which are our rivals in the world's markets for raw materials and agricultural produce. In the aggregate, therefore, our exports must be prepared to face great difficulties in the initial years of peace.

A factor of equal weight is the disparity of monetary trends in India and elsewhere which we have stressed above. Given the 18d. parity, our prices will prove far higher than those of our rivals. Prices of foodgrains in India have risen in the proportion of 100:303 and those of our chief export articles in the proportion of 100:240. The wholesale price level in the United States records a rise from 77 to 103; and the price level of farm products from 65 to 123. In Canada, wholesale prices have mounted from 75 to 100 while prices of farm products have risen from 64 to 96. With transport costs, the prices of farm

products will show a much smaller change. Allowing for the approximate character of all such statistics, it is clear that adherence to the present parities is nothing short of a sentence of exclusion from world markets passed on this country.

While exports have these dubious prospects, our need for imports for consumption and, specially, investment will be more acute than ever before. And if the present parity is allowed to stand, imports will be facilitated. These circumstances point inevitably to a prolonged control of our exchanges till a more economic parity for the rupee assures this country, a fair basis for international trade.